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# SMALL AND MEDIUM ENTERPRISES (SMEs) PERCEPTIONS OF INCOME TAX COMPLIANCE AND ITS EFFECTS ON FINANCIAL PERFORMANCE IN MALAWI

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# Abstract

SMALL AND MEDIUM ENTERPRISES (SMEs) PERCEPTIONS OF INCOME TAX COMPLIANCE AND ITS EFFECTS ON FINANCIAL PERFORMANCE IN MALAWI



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**Purpose:** This quantitative research aims to evaluate the perceptions of Small and Medium Enterprises (SMEs) in the cities of Malawi, namely Lilongwe, Blantyre, Zomba, and Mzuzu, concerning their income tax compliance and its influence on their financial performance for the fiscal year ended on December 31, 2022. The study investigates the extent of SME compliance with income tax regulations enforced by the Malawi Revenue Authority (MRA) and analyzes how this compliance, or lack thereof, affects their financial performance.

**Methodology:** To assess SMEs' compliance with income tax laws, the study conducts a comprehensive descriptive analysis of personnel and entity characteristics alongside the level of tax compliance. To examine the impact of income tax compliance on sales and profitability, the study employs simple descriptive statistics in the form of graphs and tables. This descriptive analysis includes cross-tabulations to determine the proportion of SMEs that are compliant or non-compliant with income tax laws and explores SMEs' perceptions of these laws and their willingness to comply.

**Findings:** The research reveals that the income tax compliance status has minimal impact on the decision-making process of SMEs, primarily because a significant majority of them are non-compliant. Among the 413 SMEs studied, 40.63% were fully compliant, 18.9% were partially compliant, and 40.39% were entirely non-compliant. The low compliance rate can be attributed to various factors, including poor implementation of general tax deterrence elements, high income tax rates, perceived unfairness in the tax system, skepticism about the taxpaying behavior of others, belief in the ease of tax evasion, skepticism regarding MRA's ability to detect non-compliance, inadequate tax penalties as a deterrent, and insufficient tax education provided by MRA

**Study limitations:** Some limitations should be noted. Firstly, the study exclusively focuses on profit-oriented SMEs. Secondly, it only estimates SMEs' perceptions regarding the impact of income tax compliance on sales and profitability, without considering historical behavior. Furthermore, the study is confined to the specific financial year of 2020 and does not investigate the dynamics of SMEs' tax compliance behavior over multiple years. Lastly, the research is based on a sample of SMEs rather than the entire population, potentially limiting the generalizability of the results to the broader SME sector in Malawi.

**Practical/policy implications**: This study holds significance in guiding the Malawi Revenue Authority to formulate effective deterrence strategies, enforcement measures, and tax education initiatives to enhance tax compliance among SMEs. Encouraging voluntary tax compliance will contribute to increased fiscal revenue collection and reduced national budget deficits. SME taxpayers, with the support of MRA, are encouraged to enhance their knowledge of tax matters, enabling them to navigate tax-related issues more effectively

# Declaration

I declare that this thesis has been composed solely by myself and that it has not been submitted, in whole or in part, in any previous application for a degree. Except where states otherwise by reference or acknowledgement, the work presented is entirely my own.

# Copyright Page

# Dedication

I would like to dedicate this thesis work to my immediate family and numerous friends. A distinct sense of appreciation to my caring and loving wife, Patience and to my children, Elizabeth and James, whose encouraging words and drive for persistence echo in my ears.

## Acknowledgement

I wish to acknowledge the valuable advice and direction throughout the research period of my research Supervisor, Dr Raimi Lukman, from Unicaf University. He showed patience, direction, guidance and imparted wisdom to me through-out the research journey. This research thesis would have been impossible without his timely input.

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This Dissertation paper would also not have been possible without the financial and moral support of the audit and accounting firm I work for, AMG Global. Let me thank the Managing Partner Dr Rex Harawa, directors, management and staff of AMG Global, for their support not only during the thesis period, but through-out my study journey with the University.

Special thanks go to my younger brother, Dr Christon Nyondo, for taking his time to critique part of the thesis document and for the valuable suggestions which made the document more reader friendly. To my sister Agness, thank you for your untiring assistance with sources of reference material and with formatting of this research document. To my parents, brothers and sister who may not understand what it is I am still doing with school, I will always love you too. To Rowland Nyirongo, a lecturer at the Malawi University of Business and Applied Sciences, I say thank you for your valuable contribution regarding the statistical aspects of this thesis.

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# Chapter 1: Background

## 1.1 Introduction

Malawi is a land locked country located in the Southern part of Africa, sharing her borders with Tanzania to the North, Mozambique to the South East, and Zambia to the West. The population of Malawi was found to be 17.6 million in 2018 (National Statistical Office, 2019) and, was projected to double to 40 million by 2040 (National Statistical Office, 2019).

Malawi is also considered one of the least developed and poorest countries in the world. In 2017, the country had a per capita Gross National Income (GNI) of US$1,180 and the country remains "one of the poorest countries in the world: 171 out of 189 on the 2017 UNDP Human Development Index. 71.5 per cent of the population can be classified as below the international poverty line of US$1.90 a day" (UNCTAD, 2020, P48). Malawi was ranked the 18th least developed nation in the world in 2017 by the United Nations Conference on Trade and Development (UNCTAD, 2020, P48). This observation seems to be echoed by the World Bank, who indicated that Malawi remains "one of the poorest countries in the world despite making significant economic and structural reforms to sustain economic growth" (World-bank report, 2021). A prominent local scholar also contended that the nation of Malawi ranks amongst the poorest nations in the World (Chipeta, 2002).

One of the reasons Malawi remains poor is that Malawi's economy is heavily dependent on the peasant farmer led agriculture sector. The sector contributes between 28 and 30% of the country's Gross Domestic Product (GDP). The sector also employs approximately 80% of the population and is the source of livelihoods for around the same proportion of the population (MoA, 2018)[1].The peasant sub-sector, which is characterized by low mechanization and low yields dominates the agricultural sector, hence the low productivity.

Unsurprisingly, the government of Malawi has historically relied on its traditional development partners to supplement its main revenue base, tax, among other sources of government revenues,

[1] MoA (Ministry of Agriculture). (2018). National Agriculture Implementation Plan. Ministry of Agriculture Headquarters. Capital Hill. P.O. Box 30134. Capital City. Lilongwe 3.

for its development and social programs. As a matter of fact, the role of tax revenues becomes even more pronounced when donor assistance wanes. For example, according to the 2017/2018 national budget statement (P. 4), Malawi was forced to craft its 2017 national budget (period covering July 2017 to June 2018) without the certainty of budgetary support from most of her traditional bilateral and multilateral donors because they were withholding their budgetary support. Not only did this cause a shock to the country's budget but also the then Minister of Finance observed that it was unlikely that the country's bilateral donors were going to resume budgetary assistance anytime soon regardless of the improvements that had been made in the management of public finances. The then Minister of Finance acknowledged that this was probably a shift in policy by development partners as a similar pattern was observed in other countries. Across the world, bilateral donors seemed to favour "off-budget support" as opposed to direct budgetary support. Consequently, the then Minister of Finance was convinced that it was time the country reorganised its fiscal framework to improve revenue collection from domestic sources. This demonstrates the increasing importance of tax as a main source of revenue for Malawi's development and social programs.

As evidence of this commitment by government, the 2013 national budget (which covered the fiscal year July 2013 to June 2014) was crafted to generate 82% of the national budget from internally generated sources, with income taxes being earmarked as one of the main contributors to this resource envelope (2013/2014 National Budget Statement). The balance, (18%) was still expected to be sourced from bilateral donors.

In the 2017/18 fiscal year, the full amount (100%) of the national budget was planned to be locally generated, and taxes were expected to be the main source of the national revenue (National Budget Statement, 2017/2018, P.4). However, this was not the case in subsequent years, for example, in 2019/2020 fiscal year, as 90.4% was planned to be generated internally, and the remainder (9.6%) externally from bilateral donors (National Budget Statement 2019/2020). Then again, in 2020/21 fiscal year, 82.2% of the national budget was expected to come from internally generated sources and the balance (17.8%) externally from bilateral donors (National Budget Statement 2020/2021, P.4). However, it is very clear that tax revenues have in the recent past played a pivotal role in the national budget. It is in view of this context that this study investigated the level of tax compliance amongst SME's, to ascertain their level of contribution to the national budget, and how they perceived it affected their sales and profitability, to ascertain their level of willingness to comply with paying the same.

Small and Medium-sized Enterprises (SMEs) are the lifeblood of economies worldwide, serving as catalysts for economic growth, innovation, and employment generation. In the context of developing countries like Malawi, SMEs are even more vital, as they contribute substantially to the Gross Domestic Product (GDP) and serve as vehicles for poverty reduction and equitable distribution of wealth. However, while SMEs play a pivotal role in Malawi's economic landscape, they face multifaceted challenges that impact their financial performance. One of the most significant challenges is navigating the intricate terrain of income tax compliance. Indeed, Small and Medium Enterprises (SMEs) play a crucial role in the economic development of many nations, including Malawi. In developing countries like Malawi, SMEs are often considered the backbone of the economy, contributing significantly to employment generation, poverty reduction, and overall economic growth (Mambulasa & Belete, 2019). Taxation is one of the primary means through which governments finance public expenditures, and it is especially critical in low-income countries like Malawi, where governments often rely on tax revenue as a substantial part of their budgets (Kumwenda, 2017). Therefore, understanding SMEs' perceptions of income tax compliance and its effects on their financial performance is of paramount importance

The financial performance of SMEs is a critical determinant of their sustainability and growth. Tax compliance can have far-reaching implications on SMEs' financial health, affecting their profitability, access to finance, and overall competitiveness (Gomez & Camelo, 2016). Non-compliance with tax regulations can lead to penalties, reputational damage, and potential business closure, whereas effective tax management and compliance can contribute to stable financial performance and access to government incentives (Bosire et al., 2019). Hence, understanding how SMEs perceive income tax compliance and how these perceptions influence their financial performance can shed light on the dynamics of this vital sector in Malawi's economy.

In the context of Malawi, there is a limited body of research that explores SMEs' perceptions of income tax compliance and its effects on their financial performance, particularly for the specific fiscal year ending on 31st December 2022. The existing literature often focuses on broad tax compliance issues in developing economies or on the challenges faced by SMEs in general. This research aims to fill this gap by providing a comprehensive analysis of SMEs' attitudes and behaviors toward income tax compliance and its impact on their financial performance, specifically in the Malawian context for the year 2022.

Given the importance of SMEs in Malawi's economy and the critical role of income tax compliance in government revenue generation and SME development, understanding these dynamics will provide valuable insights to policymakers, business owners, and other stakeholders. The findings of this research can inform policy decisions aimed at promoting tax compliance, improving the business environment for SMEs, and ultimately fostering economic growth in Malawi.

Income tax compliance is a cornerstone of fiscal policy, enabling governments to collect revenue for public services, infrastructure development, and social welfare programs. For a country like Malawi, where the government relies heavily on tax revenues to fund essential services, ensuring income tax compliance among SMEs is of paramount importance. Nevertheless, the burden of income tax compliance can be particularly daunting for SMEs due to their limited resources, financial constraints, and the intricacies of tax regulations.

### 1.1.1 Significance of SMEs in Malawi

SMEs occupy a central place in Malawi's economy, contributing to economic growth, employment generation, and poverty alleviation. These enterprises encompass a diverse spectrum of industries, ranging from agriculture and small manufacturing to services and trade. The importance of SMEs in Malawi's economic landscape cannot be overstated:

SMEs are responsible for employing a significant portion of the Malawian population, providing livelihoods and economic security to many (Malawi Confederation of Chambers of Commerce and Industry, 2020). In a country where unemployment and underemployment are persistent challenges, the role of SMEs as job creators is paramount.

The contribution of SMEs to Malawi's GDP is substantial, with estimates suggesting that they constitute approximately 26% of the country's GDP (World Bank, 2020). This economic contribution underscores their critical role in driving economic development and poverty reduction.

SMEs are characterized by their agility and adaptability, which allow them to respond swiftly to changing market dynamics and innovate in resource-constrained environments. These attributes make them essential engines of economic diversification and resilience.

### 1.1.2 Income tax compliance and SMEs

Income tax compliance refers to the adherence to tax laws and regulations set by the government, encompassing activities such as accurate income declaration and timely payment of taxes. In the context of Malawi, where government revenue collection heavily relies on tax income, income tax compliance among SMEs takes on a heightened significance. However, SMEs often encounter difficulties in navigating the complexities of tax regulations, fulfilling reporting requirements, and managing the financial implications of compliance. Tax compliance is a multifaceted concept that encompasses not only adherence to tax regulations but also the willingness and attitudes of taxpayers towards fulfilling their tax obligations (Braithwaite, 2003). For SMEs in Malawi, tax compliance can be a complex issue due to factors such as limited resources, lack of awareness, bureaucratic inefficiencies, and sometimes, a culture of informality (Chavula, 2014). These challenges can influence how SMEs perceive and engage with income tax compliance, and, consequently, impact their financial performance.

SMEs face distinct challenges when it comes to income tax compliance:

Complexity of tax laws: Tax regulations can be intricate and difficult to decipher, posing a significant challenge for SMEs with limited access to financial and legal expertise (McGee & Poddar, 2019).

Resource constraints: SMEs often lack the financial and human resources required to manage tax-related tasks effectively, including record-keeping, tax calculations, and filing (World Bank, 2020).

Tax literacy: A lack of tax knowledge and awareness among SME owners and operators can hinder compliance efforts (Alm, 2012).

Informality: Many SMEs in Malawi operate within the informal economy, outside the purview of formal tax structures. This informality adds complexity to tax compliance issues (Malawi Revenue Authority, 2019).

Access to information: SMEs may struggle to access relevant information and support from tax authorities, hindering their compliance efforts (Mwai, 2017).

### 1.1.3 **Factors influencing income tax compliance by SMEs**

Several factors influence the income tax compliance behavior of SMEs in Malawi. These factors can be categorized into internal and external determinants:

#### 1.1.3.1 Internal determinants:

Tax knowledge and awareness: The level of tax knowledge and awareness among SME owners and operators is a crucial internal factor influencing compliance. SMEs with a better understanding of tax regulations are more likely to comply (Alm, 2012)

Financial capacity: The financial resources and capacity of SMEs play a pivotal role in their ability to meet tax obligations. Limited financial resources can make tax payments burdensome for smaller enterprises (World Bank, 2020).

Management practices: The efficiency of financial management practices within SMEs can impact their ability to calculate and meet tax obligations accurately (Mwai, 2017).

#### 1.1.3.2 External determinants:

Tax rates: The level of tax rates imposed on SMEs can influence their compliance behavior. Higher tax rates may deter compliance, especially among resource-constrained enterprises (Oats & Onoma, 2015).

Penalties and enforcements: The severity of penalties for non-compliance and the effectiveness of tax enforcement mechanisms can shape SMEs' compliance decisions (Fjeldstad et al., 2014).

Access to tax incentives: The availability and accessibility of tax incentives and exemptions can encourage SMEs to comply with tax regulations (Bahl & Bird, 2008).

Cultural and social factors: Sociocultural norms, values, and attitudes toward taxation can influence SMEs' willingness to comply (Mmopelwa, 2018).

Government support system programs: The existence of government programs that provide training, support, and incentives for SMEs can encourage compliance (Malawi Confederation of Chambers of Commerce and Industry, 2020).

### 1.1.4 **Impact on financial statements**

The financial performance of SMEs encompasses various dimensions, including profitability, liquidity, and growth potential. Income tax compliance has a direct impact on SMEs' financial health:

Profitability: Non-compliance can lead to fines, penalties, and legal proceedings, all of which reduce profitability by increasing costs. Compliant SMEs may benefit from reduced tax liabilities, which can positively affect their bottom line (De Mooij & Keen, 2014).

Liquidity: Income tax payments represent a cash outflow for SMEs, potentially affecting their liquidity and working capital. Compliance may require SMEs to manage their finances more prudently (Mwai, 2017).

Growth and investment: Non-compliance can hinder SMEs' access to finance and credit, limiting their ability to invest in expansion and innovation (Fuest et al., 2015).

Reputation: Non-compliance can tarnish the reputation of SMEs, leading to decreased customer trust and reduced business opportunities (Wenzel, 2002).

### 1.1.5 **The Malawi business environment.**

The broader business environment in Malawi plays a pivotal role in shaping the income tax compliance behavior of SMEs:

Economic stability: The overall economic stability of the country affects SMEs' ability to generate income and meet their tax obligations (World Bank, 2020).

Access to finance: The availability of financing options and credit access can influence SMEs' financial capacity to pay taxes (Malawi Confederation of Chambers of Commerce and Industry, 2020).

Infrastructure: Adequate infrastructure, including transportation and communication networks, can impact SMEs' efficiency and competitiveness (Mkandawire & Munthali, 2016).

Regulatory reforms: Government efforts to simplify tax regulations and reduce compliance burdens can positively influence SMEs' willingness to comply (Malawi Revenue Authority, 2019).

As far as tax compliance is concerned, it can be said that it is a complex undertaking to craft a tax structure that is fair to the overall majority of the public. As a consequence, Adam Smith, a renowned British Economist, came up with four basic regulations, rules and philosophies of a good tax policy. These are “equity; certainty; convenience and economy” as outlined in Adam Smith’s book called “The Wealth of Nations”. These are generally regarded as “the four canons of taxation” because they must be present in any tax good system (Smith, 1776).

In line with the context provided by the aforementioned tax philosophies, this study investigates SME perceptions of the impact of income tax compliance level and its effects on the sales and profitability of SMEs in Malawi, with specific concentration of SMEs situated in the four cities of Malawi, namely, Lilongwe, Blantyre, Mzuzu and Zomba.

To the best of my knowledge, no studies have been done in Malawi relating to this subject matter. However, a few studies in Malawi have investigated other related tax questions. For instance, Chipeta (2002) focused on the second economy and tax yield in Malawi. This study revealed a number of interesting facts about the Malawian tax system. Firstly, it revealed that tax rates in the country were considered as very high, so high, that they forced a section of the Malawian economy to go underground, by forcing formerly tax compliant businesses underground to start evading taxes. Secondly, the study revealed that high excise taxes, high import duties and high VAT rates were among the major factors behind the growth of the parallel economy. This study vaguely put overall income tax compliance at the rate of 40% amongst entities in the country.

Another study by Chiumia and Simwaka (2012), investigated the “country’s tax policy developments, donor inflows and economic growth in Malawi”. This study also revealed a number of interesting facts about the Malawi’s tax system. First, the study showed that reducing the tax burden by tax payers by 1% was capable of raising Malawi’s economic growth by at least 0.8%. Similarly, reducing tax collection by 1% through expenditure can raise economic growth by 0.6%. Further, Chiumia and Simwaka (2012) argued that taxes in Malawi have grown to an extent that they are negatively affecting the national economic growth. Collectively, these results suggest the need for reduced tax rates to stimulate the country’s economic growth.

The current study closes the knowledge gap highlighted in this section by investigating SME perceptions of their current level of income tax compliance and its’ effects on their financial performance. The study hopes to highlight what needs to be done to encourage tax compliance, by SMEs, without necessarily affecting their sales and profitably negatively.

There is therefore no empirical study in Malawi regarding the income tax compliance level as well as the impact such income tax compliance has in Malawi. Except for a few short papers in other countries like Nigeria, Kenya and South Africa regarding the related area of study such as Implication of tax rates on sales of small and medium entities, no such studies have taken place in Malawi.

In general, the area of tax is not a very well-developed area in Malawi. There is also no formal qualification in taxation awarded by the Universities in Malawi, making the tax area one of the least developed areas in the country. Hence this study aims at closing the existing tax literature gap regarding the current income tax compliance level in the country as well as the impact such income tax compliance has on SMEs in Malawi.

As per the world bank report of May, 2022, the 2019 Finscope Micro, Small and Medium Enterprises (MSMEs) estimated that there were about 1.6 million MSMEs in the Malawi which employed about 1.8 million people in total. This report established that approximately 74% of the enterprises were micro enterprises, 23% were small enterprises and only 3% were considered as medium enterprises. The report estimates that the Micro, Small and Medium Enterprise sector "contributes about 40% of gross domestic product (GDP) and 24% of employment, and that about 21% of the country's adult population derives their livelihood from the sector". This level of contribution cannot be said to be small.

Notwithstanding the high number and likelihood to contribute further to the national economy, the "capacity of the MSMEs to expand remains low because they often do not have the same access to knowledge and networks as larger businesses" (World Bank Report 2022, p. 1). The report states that SMEs have limitations in many areas with tax management as one such area with limitation.

## 1.2 Problem statement

According to Akter & Das (2016), Small and Medium-sized Enterprises (SMEs) form a vital component of developing countries' economies, including that of Malawi, contributing significantly to employment, GDP, and poverty alleviation. Despite their importance, SMEs in Malawi face several challenges, one of the most critical being the complexity of income tax compliance. The extent to which income tax compliance practices affect the financial performance of SMEs in Malawi is a matter of great concern (Kapunda & Lungu, 2018). It has wide-reaching implications for the sustainability and growth of these enterprises, as well as the country's economic development. Therefore, an in-depth exploration of this relationship is imperative

According to Gemmell et al. (2016), existing research on income tax compliance and its impact on business performance is abundant, particularly in developed economies. However, there is a noticeable research gap in the context of Malawi. The current literature primarily focuses on taxation in advanced economies and often neglects the distinct challenges and opportunities faced by SMEs in Malawi (Kasomekera & Isife 2017). Consequently, there is a scarcity of empirical evidence regarding how income tax compliance practices, such as adherence to tax regulations and tax planning strategies, influence the financial performance of SMEs in this specific context (Chidiebere-Mark & Nwosu, 2020).

This research therefore aims to close the gap in extant literature pertaining to the influence of income tax compliance on the financial performance of SMEs in Malawi. Consequently, the research investigates SMEs' perceptions of the impact of income tax compliance on their financial performance in the Malawian cities of Lilongwe, Blantyre, Zomba and Mzuzu. By addressing the gap in the existing literature and conducting quantitative research, this study seeks to contribute to a detailed understanding of the challenges faced by SMEs in meeting their income tax obligations and the resulting consequences for their financial well-being. The study seeks to shed light on the complex relationship between income tax compliance and financial performance from the Malawi SME perspective. Eventually, the findings can provide valuable insights for policymakers and practitioners, enabling them to develop more tailored strategies to support SMEs in achieving better financial outcomes while meeting their income tax obligations. Ultimately, this research offers valuable insights for policymakers, tax authorities, and stakeholders seeking to support and enhance the resilience of SMEs in the face of income tax compliance challenges.

## 1.4 Significance of the Study

SMEs play a pivotal part in the Malawi economy, contributing to employment, innovation, and economic growth. However, the intricate relationship between income tax compliance and SMEs' financial performance remains underexplored. This study aims to investigate SMEs' perceptions regarding the impact of income tax compliance on their financial performance. By delving into this crucial area, this research seeks to uncover the significance of this relationship and conduct a comprehensive gap analysis, addressing the existing void in the literature. Ultimately, the findings will contribute to a detailed understanding of the challenges faced by Malawi's SMEs in the framework of income tax compliance and its consequences for their financial health.

With the conviction of the then Minister of Finance that it was time the country started reorganising its fiscal framework without expecting much of the budgetary support that the country had been accustomed to receiving from abroad since independence in 1964 as well as the realization, by the same the then Minister of Finance, that there was evidence that donors were also decreasing the budgetary support which they had been traditionally providing through project grants, it is critical to find out the exact level of income tax compliance of a key ta paying industry in Malawi, the SMEs. It is also important to know the impact identified level of income tax compliance has on financial performance of SMEs.

For emphasis, in the Malawi budget year of 2013/2014, the Malawi Government was then following a July to June financial year. Subsequent to June 2021, the Malawi Government changed its financial year, to run from April to the following March, the Malawi Government budgeted to obtain 82% of its revenue from internally generated resources in form of tax revenue, while the remaining 18% was budgeted to come from donors (National Budget statement, 2013. Come 2017/2018 financial year, 100% of the budget was planned to come from tax revenue with nothing budgeted to come from donors (National budget statement (2017). Come 2020/2021 budget year, 82.2% was budgeted to come from tax revenue with the balance of 17.8% being budgeted to come from donors (National budget statement 2020). It can be said from the above-mentioned national budget statement that internally mobilized tax revenues have become an increasingly important source of revenue in Malawi. It can also be stated that mobilization of tax revenue is increasingly becoming a key to this country's survival.

Besley and Persson (2009), Gaspar and others (2016) are all in agreement that growth of the tax collection base is important for progression of the economy as well as general development of a country. Improvement in tax revenue is very important for realization of the Sustainable Development Goals (IMF, 2018). It can therefore be stated that the country is becoming more and more dependent on internally generated revenues, in form of taxes.

Below are specific highlights of the significance of this study:

### 1.4.1 Economic significance of SMEs in Malawi

SMEs are vital contributors to employment, innovation, and economic development in Malawi, a country which is largely made up of SMEs. SMEs are noted in the developing countries as "units that contribute widely to establishment of employment, tax collection" as well as the decline of poverty (Miller et al. 2018). According to Miller et al (2018), it is generally observed that SMEs are usually not public in nature and usually meet problems when it comes to dealing with the Tax Revenue Authorities. SME problems with the tax authorities may be taken to be due to "poorly formulated income tax policies". The majority of entities in the country are SMEs. According to the National Statistical Office of Malawi as well as the World Bank, approximately 90% of the entities in Malawi are Micro, Small and Medium entities (MSMEs). It can therefore be stated that overall, Malawi is an SME country. Understanding the factors that influence their financial performance, particularly income tax compliance, is essential for sustaining and enhancing their contribution to the economy.

### 1.4.2 Income tax compliance challenges

SMEs often face unique challenges when it comes to income tax compliance. These challenges may include navigating complex tax codes, resource limitations, and the burden of compliance itself. Investigating how these challenges impact SMEs' perceptions and financial performance is of utmost importance. According to Dlamini (2017), SMEs in Africa have a high-income tax non-compliance rate which results in reduced fiscal collection and subsequently negatively affects the national development. However, as Baurer (2005) puts it, it "would be rare indeed to not observe complaints about the complication and/or ambiguity of the tax laws as well as high tax rates" (p 16). It can therefore be stated that SMEs find tax rates high and tax policies difficult to comprehend. According to Mnewa and Maliti (2008), Miller et al (2018), a big burden to SMEs can be made if income tax policies are not properly made taking into account the unique environment of each nation, which has the ultimate impact of negatively affecting the ability of SMEs to pay their taxes.  Many SME entities remain uncertain regarding attainment of expected sales and profitability due to what Baurer (2005) calls "hostile income tax policies". It is therefore important for any Government to reflect very "carefully, aspects which may influence on efficiency, economy and effectiveness of SME entities" (Wongsaroj & Miller 2018 p 27), This is because, According to Miller and Wongsaroj (2018), small and medium entities remain key to economic growth of all nations, both developing and developed.

### 1.4.3 Financial performance implications

Income tax compliance can have direct and indirect effects on the financial health of SMEs. Effective compliance strategies can enhance profitability and long-term sustainability, while non-compliance can lead to penalties, legal issues, and resource drain. According to the Organization of Economic Community Development (OECD) (2012), the developed nations noted "better tax compliance of SMEs to be proportionately related to their long-term sustainability and growth". Thus, in the developed world, the more SMEs complied with their income tax obligations, the higher the sales and the higher the related profitability. Better tax compliance was not necessarily found to be a panacea to all the problems of SME enterprises, but according to OECD (2012), income tax compliance was found to clearly play a critical role to SME's overall long-term health and performance. According to OECD, the financial performance of SME entities in terms of sales and profitability, benefited more and to a greater extent depended on good compliance with income tax principles. The higher the level of income tax compliance, the better the financial performance in terms of sales and profitability of SMEs and vice-versa (OECD 2012). However, some studies done in other parts of the continent and beyond found a substantial adverse relationship between company income tax compliance and financial performance. (Gadzo, Gatsi, and Kportorgbi 2013; Porto & Santoni 2016, Bolboros 2016 Kurawa 2018). It is stated that "the buying power of an SME declines immediately after the income tax payment" (Chipeta 2002, p. 2). Money which could have been used to enhance the growth of an SME is instead paid to the tax authority in form of taxes. This forces many SMEs to hide under-ground, away from being taxed (Chipeta 2002 and Chiumia & Simwaka 2012). A study done on the African continent by Tee et al (2016), Stumpfegger (2017) and Oladele, et al (2019) noted that the money which could have been used to expand SME business was instead used to pay tax. These earlier studies also noted that the buying power of SMEs dropped soon after taxes were paid.

The study is therefore of great significant to tax strategists, tax policy makers, tax collection implementers as well as other interested persons to comprehend existing compliance levels of income tax of SMEs in Malawi. Knowledge of the level of income tax compliance will close an existing gap in this area, especially that there are few to no studies in the area of taxation in the country. The study is also of significant to the researcher personally too. The researcher has interests in three SMEs: an audit firm, a travel agency and a cosmetics shop in Malawi. Knowledge gained from the research will inform the researcher to manage his SMEs better and take them to another level. This is besides attainment of prestige and social respect associated with the attainment of a Doctor of Philosophy Degree. It is therefore important to learn about the perceived impact identified level of income tax compliance (whether fully compliant, partially compliant or not compliant at all) has on financial performance of SMEs in Malawi. This knowledge will close the gap which currently exists. Small and medium organizations represent over 90% of private businesses and they contribute to more than 50% of employment and GDP in most African countries. In Ghana, smaller entities characterized by the "production landscape have been noted to provide about 85% of manufacturing employment" (Aryeetey et al 2004).

## 1.5 Research objectives

The objectives of this research study are as follows:

1. To explore the perceptions, attitudes, and beliefs of SME owners and managers regarding the fairness, transparency, and ease of compliance with income tax regulations.
2. To analyze the effects of income tax compliance, including penalties and incentives, on SMEs' financial performance, such as their ability to invest and grow.
3. To identify and categorize the common challenges and barriers faced by SMEs in adhering to income tax compliance regulations in Malawi.
4. To analyze the long-term consequences of income tax compliance on SMEs, such as their sustainability and contributions to the Malawian economy.
5. To determine the factors that significantly impact SMEs' perceptions of the income tax system, including government support and tax incentives.
6. To assess the financial performance of a sample of SMEs in Malawi by analyzing key indicators such as profitability, liquidity, and growth.
7. To propose practical recommendations for policymakers, tax authorities, and business associations to enhance income tax compliance among SMEs and improve their financial performance in Malawi.

8. To offer insights into potential policy changes or reforms that may be necessary to improve income tax compliance and financial performance among SMEs in Malawi.

**1.6 Research Questions and Research Hypothesis**

The study investigated if SMEs in Malawi, comply fully, partially or not at all with the income tax system charged on profits of trading entities, by the Malawi Revenue Authority. The other aim of the study was to evaluate the effect, if any, such perceived level of income tax compliance has on financial performance of SMEs in Malawi. The evaluation of the effect revolves around finding out if compliance with income tax regime results into increased or reduced sales and profitability. Financial performance was measured by way of levels of SME sales as well as related profitability.

Following from the research objectives, problem and purpose statement above, the following are the research questions:

1. What are the perceptions of SMEs on the fairness of the current income tax regime?
2. What is the effect on decision-making processes of the SME of complying with the income tax regime?
3. Why are some SMEs not registered for income tax?
4. What are the challenges faced by SMEs when complying with the existing income tax regime? What can be done to surmount these challenges?
5. Is there a relationship between perceived levels of income tax compliance and SMEs' perceptions about their sales?
6. Is there a relationship between perceived levels of income tax compliance and SMEs perceptions about the profitability of their business?
7. What is the effect of tax deterrence instruments/tax morale on income tax compliance levels?
8. What is the relationship between moderating variables (age, gender, level of education and SME size) and income tax compliance level?

Following from the research questions above, the following are the research hypothesis:

H10 There is no significant relationship between income tax compliance and SME decision-making process

H1a There is a significant relationship between income tax compliance and SME decision-making process

H10 There is no significant relationship between perceived levels of income tax compliance and sales of SMEs

H1a There is a significant relationship between perceived levels of income tax compliance and sales of SMEs

H20 There is no significant relationship between perceived levels of income tax compliance level and profitability of SMEs

H2a There is a significant relationship between perceived levels of tax compliance and profitability of SMEs".

H20 There is no significant relationship between tax deterrence instruments/tax morale and income tax compliance level of SMEs

H2a There is a significant relationship between tax deterrence instruments/tax morale and income tax compliance level of SMEs"

H20 There is no significant relationship between moderating variables (age, gender, level of education and SME size) and income tax compliance level of SMEs

H2a There is a significant relationship between moderating variables (age, gender, level of education and SME size) and income tax compliance level of SMEs".

**1.7 Definition of operational terms as used in the study**

SMEs play a crucial part in the economy of Malawi, contributing significantly to job creation and economic growth. The majority of entities in the country are considered to be SMEs. According to the National Statistical Office of Malawi as well as the World Bank, around 90% of the entities in Malawi are considered as Micro, Small and Medium entities (MSMEs). It can therefore be stated that overall, Malawi is an SME country. Nevertheless, SMEs often face complex challenges, including tax compliance.

The interaction of various factors such as financial performance, tax deterrence, and tax morale influences SMEs' decisions regarding tax compliance. To better understand this dynamic, we present a summary framework that defines and explores these operational terms.

### 1.6.1 Income tax compliance

Income tax compliance refers to the extent to which SMEs adhere to the income tax laws and regulations of their respective jurisdictions. This includes accurately reporting income, paying taxes on time, and maintaining proper records. Non-compliance can result in penalties, fines, or legal actions. The term "tax compliance" can also be defined as "the tendency of the taxpayers to adhere to their tax responsibilities laid down by the law of the country for the purpose of a balanced economy" (Alshirah et al., 2020, p7). A social researcher defines tax compliance as "the reporting of the total incomes and payment of taxes required by the established regulations, laws and court judgments; the act of taxpayers in declaring their taxable income accurately, in filing tax returns as well as in paying their tax liabilities within the time period required" (Alm, 1999, p16); "the taxpayer's filing of the total required tax returns in a manner that is timely, with the returns encapsulating the right reported tax liability on the basis of applicable tax laws, regulations and court decisions applicable" (Roth et al., 1989). Kirchler et al. (2006) equated the tax compliance concept to a "game that depends on the reciprocal interactions between the decisions of the taxpayer and the tax authority, as well as the trust of taxpayers in the law, and the tax system fairness". In contrast, tax non-compliance is defined in terms of two tax concepts, namely, tax evasion and tax avoidance. Tax evasion denotes the deliberate misstatement and misrepresentation of tax matters by both individuals and entities, it is the "evasion of illegal and intended businesses of entities and individuals for tax due to minimization by underreporting sales, income or wealth, heightening deductions, loans or dispensations, or by refraining from filing tax returns in an accurate manner" (Alshirah et al 2020, p2). As put clearly by Sandmo (2003), Alley (2002); Webley (2004) and Bătrâncea et al (2012), tax evasion is a violation of the law. "When the taxpayer refrains from reporting income from labor or capital which is in principle taxable, he engages in an illegal activity that makes him liable to administrative or legal actions from the authorities". Tax avoidance, on the other hand, involves minimization of tax payable using legally acceptable means, within the tax legal framework. It can be stated that tax avoidance does not involve breakage of any tax laws.

This study adopts the income tax compliance definition provided by Bătrâncea et al. (2012), that requires the following four principles to be true for an entity to be said to be tax compliant: that "correct income tax basis need to be used; correct income tax computation need to be made; the tax return need to be done within the stipulated filing period and finally, correctly assessed tax amount must be paid within the agreed time with the Revenue Authority" (p 14). Full income tax compliance means that all these four elements have been fully complied with. Any non-compliance with at least one of these elements implies partial compliance. Where completely none of these four elements have been complied with, it implies that there is no compliance at all.

### 1.7.2 Financial performance of SMEs

Financial performance encompasses an SME's economic well-being and profitability. It is assessed through various financial indicators, including revenue, net income, profitability ratios, and liquidity. For the sake of this study, financial performance is viewed in terms of SME sales and profitability. SMEs with strong financial performance are better equipped to meet their tax obligations

### 1.7.3 Perceptions of income tax compliance

These relate to subjective beliefs, attitudes and opinions regarding their own level of income tax compliance. The indicators are confidence in tax compliance, perceived tax burdens and awareness of tax incentives.

### 1.7.4 Tax deterrence

Tax deterrence involves the strategies and measures implemented by tax authorities to discourage tax evasion and non-compliance. This may include audits, investigations, penalties, and legal actions against SME tax offenders. Tax deterrence aims to create a perceived risk for SMEs that may consider evading taxes

### 1.7.5 Tax morale

Tax morale reflects SMEs' readiness to voluntarily observe laws of tax due to ethical or moral considerations. It is influenced by the perception of fairness of the system of tax, trust in government, and the belief that paying taxes contributes to societal welfare. High tax morale is associated with a greater propensity for SMEs to comply with tax obligations. Tax payers who believe that they are considered highly in society are more likely to have higher compliance attitude than those who are not.

### 1.7.6 Institutional theory

Institutional theory relates to the framework used to understand how institutions, including legal and regulatory systems, shape individuals' and organizations' behavior. It refers to a framework for understanding how formal and informal institutions shape tax systems, tax policies, and tax compliance behavior. Institutions in the context encompass a wide range of entities and systems that influence the way taxation operates within society or jurisdiction.

### 1.7.7 Behavioral economics theory

This is an interdisciplinary field that combines insights from psychology and economics to study how people make decisions. In taxation, behavioral economics theory focuses on understanding the psychological and cognitive factors that influence taxpayers' behavior, including their compliance decisions with tax obligations. In essence, it examines how individuals and businesses make tax related decisions that may not always align with traditional economic models based on rationality

### 1.7.8 Tax complexity theory

Tax complexity theory explores the impact of the complexity of tax systems on taxpayers' behavior and compliance. It recognizes that tax laws can be intricate, requiring significant time and effort to understand and comply with. Complexity can affect individuals and businesses differently, and it can have both intended and unintended consequences as it encompasses the challenges individuals and businesses face in the understanding, interpreting, and complying with tax codes. The tax complexity concept theory focusses on the intricate and convoluted nature of tax systems, including complex tax laws, regulations and administrative procedures, and examines how this complexity impacts various aspects of taxation. It explores the challenges that individuals, businesses, and tax authorities face when dealing with intricate tax codes and rules.

### 1.7.9 Relationships amongst operational terms

The interplay between tax compliance, financial performance, tax deterrence and tax morale is complex and multifaceted. Below is how these terms interact within the Small and Medium Enterprise context.

#### 1.7.9.1 Financial performance and tax compliance

SMEs with healthier financial performance are more likely to comply with tax obligations. Strong financial stability allows SMEs to meet their tax liabilities without resorting to evasion or non-compliance. Conversely, SMEs facing financial difficulties may struggle with tax compliance due to limited resources.

#### 1.7.9.2 Tax deterrence and tax compliance

Effective tax deterrence measures can influence SMEs' decisions regarding tax compliance. The fear of audits and penalties can encourage SMEs to adhere to tax laws. However, excessive or arbitrary deterrence measures can also lead to tax evasion as SMEs seek to minimize their tax burden.

#### 1.7.9.3 Tax morale and tax compliance

Tax morale significantly affects SMEs' willingness to comply with tax laws. When SMEs believe that paying taxes is fair and contributes to societal welfare, they are more likely to voluntarily comply. Conversely, a perception of unfairness or corruption can erode tax morale and lead to non-compliance

#### 1.7.9.4 Financial performance and tax morale

SMEs with strong financial performance may have higher tax morale since they can more readily see the benefits of tax contributions to society. Conversely, financially strained SMEs may perceive tax payments as burdensome, potentially leading to lower tax morale and non-compliance

1.7.9.5 Tax morale and tax deterrence

Tax morale can influence the effectiveness of tax deterrence measures. High tax morale may reduce the need for stringent deterrence, as SMEs are motivated to comply voluntarily. Conversely, low tax morale may necessitate more aggressive deterrence measures to ensure compliance

In the context of SMEs, tax compliance, financial performance, tax deterrence, and tax morale are interrelated and collectively shape the behavior of SME taxpayers. Understanding this interplay is essential for policymakers, tax authorities, and SMEs themselves. Effective policies should aim to enhance tax morale, promote fair tax systems, and balance tax deterrence measures to encourage voluntary compliance while maintaining a conducive environment for SMEs' financial growth and sustainability.

# Chapter 2: Literature review

## 2.1 Chapter outline

This chapter deals with overall existing literature surrounding the perceived impact of income tax compliance on financial performance of Small and Medium sized entities in Malawi. The chapter also deals with the study's theoretical framework.

The chapter is thinly arranged into four sections: firstly, is a discussion of general conceptual framework of income tax compliance, namely, general economic deterrence and social psychology deterrence. This sub-section also discusses brief income tax in Malawi, general tax concepts; definition of tax; types of tax; purpose of tax and tax compliance issues, including a general discussion of principles of tax. Secondly, the chapter discusses current literature surrounding level of income tax compliance in Malawi and similar compliance levels in Africa as well as the rest of the world, together with related impact of income tax compliance on financial performance. Thirdly, the chapter discusses current literature surrounding tax compliance determinants in Africa and the rest of the world.

Finally, the chapter lays down the study's specific theoretical framework.

## 2.2 Theoretical framework

### 2.2.1 Introduction

Small and Medium Enterprises (SMEs) are recognized as a vital pillar of economic development, contributing substantially to employment, innovation, and economic growth in both developed and developing economies (Acs & Audretsch, 1990; Stiglitz, 2019). In the context of Malawi, SMEs constitute a substantial portion of the nation's business landscape, offering a myriad of advantages to the country, from job creation to poverty alleviation (Malawi Government, 2018). However, SMEs in Malawi, like their counterparts worldwide, are subject to a complex regulatory environment that includes income tax compliance—a crucial dimension of their financial and operational reality.

The year 2022 is of particular significance in the history of Malawi's economy, marked by pivotal events, structural reforms, and unforeseen global challenges. During this time, SMEs faced unique conditions concerning income tax compliance that have the potential to significantly impact their financial performance. This literature review endeavors to provide a comprehensive analysis of the perceived impact of income tax compliance levels on the financial performance of SMEs in Malawi during the year ended 31st December 2022. Hence, the aim of this study was to assess SME perceptions of the impact of income tax compliance level on the financial performance of Small and Medium Enterprises (SMEs) in Malawi during the year ended 31$^{st}$ December 2022. The study found out if SMEs in Malawi, pay fully, partially or not at all, income tax charged on profits made by businesses, by the Malawi Revenue Authority. The study also evaluated the effect, if any, such perceived level of income tax compliance has on financial performance of SMEs in Malawi, Malawi. For example, whether full, partial or absolute non-compliance with the income tax regime results into increased sales and profitability or not. Financial performance is measured by way of perceived level of sales and related profitability of selected SMEs.

The study followed the quantitative method approach because it measured SME perceptions of the level of income tax compliance as well as if a relationship existed between the following variables: current level of income tax compliance on one hand and the impact such perceived level had on financial performance (financial performance being measured in terms of perceptions of sales and profitability of related SMEs) on the other hand. Perceptions were captured on a three-to-five-point likert scale. The study instrument collected data in form of numbers which were subsequently keyed in and analyzed using a statistical software, STATA.

The study was done through a questionnaire survey instrument as a main data collection tool. The questionnaire was administered to SMEs by research assistants through electronic tablets. Completed questionnaires were electronically transmitted to the central server for further processing. SMEs were selected on a random basis to avoid any bias as well as to give equal chance of selection to all SMEs.

Four basic facts need to be true if a taxpayer is to be said to be fully compliant with the income tax law: Firstly, correct income tax basis need to be used, for example, correct income tax rate need to be used. Secondly, correct income tax computation needs to be made. Thirdly, the tax return needs to be done within the stipulated filing period. Finally, correct assessed amount need to be paid within the stipulated time frame (Bătrâncea et al 2012, p 14). Failure to follow all or any of these basic rules is tantamount to non-compliance and partial compliance respectively.

According to Bătrâncea et al (2012), Lee (2015) and Michael et al (2019), two tax terms emerge whenever the issue of non-compliance with income tax comes up. These are: tax avoidance and tax evasion. The two terms are further briefly described below.

Tax avoidance is acceptable as it basically involves using the tax law to the advantage of the taxpayer. Tax avoidance is said to be legal as it adopts the manipulation of the statutory ambiguities with the aim of paying less taxes by some form of acceptable creative forms of accounting, hence not committing any criminal activity (James 2002; Webley 2004; Hearson 2018 and Amoh et al. 2019). This is always done in full agreement with tax law. Tax evasion motivating factor is, on the other hand, not to pay any tax or paying very little tax deliberately and knowingly by misrepresenting the facts (Elffers et al 1997; Lee 2015; Michael et al. 2019). The below definition of the two terms given earlier on by Sandmo (2003) sums it all:

> When the taxpayer refrains from reporting income from labor or capital which is in principle taxable, he engages in an illegal activity that makes him liable to administrative or legal actions from the authorities. In evading taxes, he worries about the possibility of his actions being detected. Tax avoidance, on the other hand, is within the legal framework of the tax law. It consists in exploiting loopholes in the tax law in order to reduce one's tax liability. In engaging in tax avoidance, the taxpayer has no reason to worry about possible detection. (p. 18)

According to Michael et al. (2021), empirical lessons recognize pertinent variances:

> in attitudes between different occupation groups: Self-employed entrepreneurs express less favorable views on taxes and the tax authorities and as a result feel more restricted and hindered in their work, while employed workers focus more on the exchange function between tax payments and the resulting provision of public goods. Despite the differences, in all occupation groups, tax evasion is not perceived as a severe crime and tax evaders are even judged quite positively as more intelligent than the typical tax payer. Michael et al. (2021) in their most recent study, states that tax evasion might not be evaluated as positive anymore as in earlier studies, but instead tax avoidance seems to be morally accepted and taxpayers engaging in tax avoidance are judged more positive than the typical taxpayer.

As noted above, tax avoidance involves working within the boundaries of the tax law, to reduce tax liability while tax evasion uses illegal means, including declaring less income and claiming more expenses than normal in order to pay less tax.

### 2.2.2 Glimpse of Malawi Income Tax based on the updated Malawi Companies Act, 2013

In 2023, the corporation tax rate in Malawi is 30% for Malawi-registered companies and 35% for branches of foreign companies on their income deemed from a source in Malawi. Foreign source-based income is exempt from taxation. As per the amended 2013 Malawi Tax Act, a company is resident if it is incorporated in Malawi; a trust, estate or partnership is resident if established or organized under any written law of Malawi. Where a permanent establishment exists, tax residence will follow.

2.2.2.1 Rates of corporate tax in Malawi

In case of all companies other than companies engaged in mining operations under the mines and mineral Act, income/corporate tax rate is at the rate of 30% of the taxable income, except the case of companies operating in priority industries which have an applicable rate of 0% for such a period, not exceeding 10 years as the minister may grant in the order: An additional tax of 5% of taxable income shall be charged in respect of all companies not incorporated in Malawi (35%), provided further that an additional tax of 10% on any taxable income above 10 billion Kwacha shall be charged in respect of a bank licensed under the Financial Services Act. Life insurance business is taxed at 30% on their investment income. Income from pension business attracts a rate of tax of 15% on the taxable income of a pensions business which includes administration fees and investment income.

There is a new mining tax regime under the 16$^{th}$ and 17$^{th}$ schedules of the Income Tax Act, 2013, which introduced a mineral royalty payable as a tax with respect to mining products at the following rates. All minerals other than precious stones and semiprecious stones and commercial minerals exported in an unmanufactured state: 5%; Commercial minerals exported in an unmanufactured state: 5%; Precious stones and semiprecious stones: 10%. The mineral royalty is payable to the Malawi Revenue Authority on a quarterly basis within 21 days after the end of each quarter of the year of assessment. Additional mineral resource rent was also introduced which is imposed at a minimum of 15% on after-tax resource rent from a project. After-tax resource rent is determined in accordance with Paragraph 23 of the 16th Schedule to the Taxation Act.

2.2.2.2 Presumptive taxes.

Presumptive taxes on turnover have been introduced for taxpayers with a turnover of less than Malawi Kwacha (MWK) MWK12,500,000. Taxpayers with turnover of less than MWK12,500,000 can now elect to pay presumptive taxes. Presumptive tax is payable quarterly. The following are the annual taxes: For income not exceeding K4 million, the turnover tax rate is zero Kwacha; for annual income exceeding K4 million but not exceeding K7 million, the turnover tax is K110,000. For income above K7 million but not exceeding K10 million, the turnover tax is K170,000; and for income above K10 million but not exceeding K12.5 million, the turnover tax is K225,000.

**Taxable income** – Taxable income comprises all Malawi-sourced receipts and accruals due to a company, including capital gains. Income specified as exempt is excluded and deductible expenses and allowances are subtracted. In general, expenditures or losses will be deductible where wholly, exclusively and necessarily incurred by the taxpayer for trade purposes or in the production of income. Expenses are guided by s 28, of the Malawi Tax Act including the new amendment to this section S28 (2) *a-d.*

**Taxation of dividends** – Malawi and foreign source dividend income is excluded from taxable income. Therefore, any withholding tax incurred may not be credited against the company tax liability and related expenses are disallowed.

**Capital gains** – Capital gains are generally taxed as ordinary income and may be further subdivided by whether capital allowances were available on the assets. If capital allowances were available, the gain may be computed as the sales proceeds less the written-down tax value. If no capital allowances were available, as is the case with shares and non-industrial or own-use buildings, the gain is reduced by an allowance based on an amount tied to a consumer price index (CPI). Subject to specific conditions, capital gains arising from involuntary conversions and for the replacement of assets acquired within 18 months may be deferred. In general, where there is no change of ultimate ownership, resulting in a qualified reorganization, a group reorganization will be tax-free with respect to capital gains.

**Losses** – Trading tax losses may be carried forward for 6 years, unless derived from manufacturing, mining or agriculture, in which case they may be carried forward without restriction. Capital losses of assets that attracted capital allowances are fully deductible. Other capital losses may be deducted only against capital gains realized in the same or future years.

**Foreign tax credit** – Subject to satisfactory evidence, a foreign tax credit will be allowed against income taxed both in Malawi and a foreign country, even in the absence of a tax treaty. The credit may not exceed the Malawi tax on the income determined at the average effective rate for the total taxable income.

**Tax Incentives** – Capital Allowances are allowable on various capital items for the manufacturing sector. Qualifying assets in the manufacturing, agricultural and tourism sectors are eligible for a 100% investment allowance in the first year of acquisition.

Pre-business expenses of up to 18 months are allowable expenses.

For companies operating in "priority" industries, the rate is either 0% for 10 years or 15% (no time limit is specified).

Disposals of shares of companies listed on the Malawi stock exchange are not taxable, provided the shares have been held for 12 months.

25% export allowance for non-traditional exports as outlined in the Export Incentives Act

25% international transport allowance for nontraditional exports

Exports are zero-rated for purpose of Value Added Tax to any taxpayer engaged in the export of Malawi produced goods indicated by proof of export.

2.2.2.3 Withholding tax:

**Dividends** – Dividends distributed by a Malawi company are taxed at 10% unless the rate is reduced under an applicable tax treaty. This is a final tax for recipients.

**Interest** – A withholding tax of 15% applies to interest payments made to non-residents, unless reduced under an applicable tax treaty. A 20% rate applies to residents, as an advance tax.

**Royalties** – Royalty payments made to a non-resident are subject to a 15% withholding tax, unless reduced under an applicable tax treaty. A 20% rate applies to residents, as an advance tax.

**Quarry stones and quarry Materials or Contractors:** 10% rate is applicable to residents.

### 2.2.2.4 Other taxes

**Value Added Tax** – is at 16.5% for VAT registered operators.

**Payroll tax** – A 1% tax-deductible levy of payroll costs is payable annually to the Technical, Entrepreneurial and Vocational Education and Training Authority (TEVETA).

**Social security contributions** – There is no formal social security system in Malawi. Thus, corporations incur many social costs, with such costs generally being tax-deductible. There is no obligation to make pension contributions.

**Fringe benefits** provided to employees are taxable to the company using cost, market value or scale rates for benefits. The costs of the benefits, excluding the fringe benefits tax, are deductible expenses. The FBT is not deductible. The tax is payable on a quarterly basis.

### 2.2.2.5 Anti-avoidance rules:

**Transfer pricing** – Transfer pricing rules were introduced as from 1 July 2009 and the tax authorities have the power to deem profits to have accrued in situations where non-arm's length transfer pricing is believed to exist.

**Thin capitalization** – While there is no thin capitalization legislation in Malawi, a deemed dividend will be imposed where the debt-to equity ratio exceeds 3:1.

**Other** – IFRS require certain related party disclosures in the annual financial statements.

**Disclosure requirements** – The tax authorities have power to require taxpayers to provide information regarding their tax affairs.

**Administration and compliance:** Malawi Tax year – The fiscal year runs from 1 April to 31 March with effect from 1 April 2022, but a Malawi company may adopt any date as its accounting year end. All taxable income is taxed in the fiscal year in which the accounting year ends.

**Consolidated tax returns** – Consolidated tax returns are not permitted; each company within a group must file its own tax return. There are no group tax reliefs in Malawi.

**Tax Filing requirements** – An annual tax return must be filed and any balance of tax paid within 180 days of the company's year-end. Provisional tax is due quarterly within 25 days of each quarter end. By the end of the fourth quarter, 90% of the final tax liability must be paid. Agricultural entities and other seasonal income earners may agree on a more equitable provisional tax schedule with the authorities.

**Penalties** – Late filing for annual company tax returns incurs a penalty of MWK 300,000 and an additional MWK 50,000 for each month that the return remains unsubmitted.
The underpayment of provisional tax results in a penalty ranging from 25% to 30% on the unpaid tax balance.
**Rulings** – Rulings may be obtained on practical or technical issues and will normally be accepted as definitive provided full disclosure has been made. It is general practice to obtain an advance clearance on the tax treatment of group re-organizations.
Under a **self-assessment system**, taxpayers are responsible for calculating their tax liability and submitting tax returns together with any outstanding tax due. The Malawi Revenue Authority accepts the return as filed and does not issue any administrative assessments. If it is not satisfied, it will undertake to verify the correctness of the information contained in the return.

#### 2.2.2.6 Tax administration SME

There are four main compliance obligations of a taxpayer that is core to tax administration business fundamentals. These are registration, the filing of tax returns, assessment of tax due, and making sure that tax liability is paid at the right time and, in the right manner. Penalties are imposed on the unpaid amount of tax.

#### 2.2.2.7 SME Taxpayers

Taxpayers are categorized into two categories as, large taxpayers and Small and Medium Enterprise because size of the taxpayer has different characteristics, and each group presents different risks, such that each category requires its own set of strategies (Bodin, 2010).
Most tax administrations have focused mainly on large taxpayers as they contribute more tax revenues; Malawi is not an exception, as over 70 % of revenues come from large taxpayers who make up about 10% of entities, against around 90% SMEs who contribute about 30% of total tax revenues (Malawi revenue collection reports, 2017)
It is evident from MRA's efforts which has been seen through implementation of strategies to put into the tax net all SMEs. These include taxpayer education, exemption from penalties for voluntary disclosure of underpayments, adoption of an electronic fiscal device (EFDs) as risk management innovation, modernization of its systems and introduction of new tax policies. There has been a minimal impact as SMEs are numerous, difficult to handle, therefore making them a

risky group. Moreover, they are challenged with limited management skills and formal education, access to credit, lack of technical know-how and inability to acquire skills and modern technology.

### 2.2.3 Income tax compliance theories in general

According to McKerchar et al, (2009); Devos, (2012); Fjeldstad, (2012), Tilahun, (2019), Malik & Younus (2019), individual persons and entity's tax compliance decisions are influenced by a multitude of factors, which are logically grouped into theories or models or schools of thought. There are five groupings of income tax theories which are generally adopted from studies by the Organization of Economic Cooperation Development (OECD) department of income Tax Administrators, and these are: Deterrence; Social Psychology, Fiscal Exchange, Comparative Treatment, Political Legitimacy and Trust in Government.

Income tax compliance of taxpayers is generally looked at from the following two hypothetical theories: economic deterrence and a wider behavioral theory (Frey, 2002; Tusubira and Nkote, 2013; Chauke & Sebola 2016 Tilahun, 2019). "The behavioral theory incorporates the social and fiscal psychological theories" (Tilahun, 2019, p. 22). These theories are now briefly discussed below.

#### 2.2.3.1 General economic tax deterrence theory

This theory states that taxpayers' compliance behaviors are prompted by elements like frequent tax audits, punitive tax rates for tax offenders and other tax punishments. These define the advantage of evading tax, together with fines relating to fraudulent tax behavior and likelihood of being detected - which decides costs to be meted on tax offenders.

The model takes a taxpayer as a normal economic person, who evaluates the costs (measured by likelihood of discovery and associated consequences for fraud and benefits determined by tax rate) of evading taxes, and hence chooses non-compliance, where the perceived costs of complying are higher than those of non-compliance (Walsh, 2012, Fjldstad, 2012 and Ali, et al 2013, Tilahun 2019, Malik & Younus 2019). This model summarizes the issue of non-compliance to the following "…..of rational decision making under uncertainty whereby tax evasion either pays off in terms of lower taxes or subjects one to sanctions" Dularif et al 2019, p, 37). This indicates that where there is a lower chance of audits and a low probability of penalties related to tax misbehavior, there will be a higher probability for tax evasion. Conversely, where likelihood of tax audits is high which will result into higher likelihood of detection together with related serious high penalties, very few taxpayers will dodge taxes (Fjldstad, Schulz-Hezenberg and Sjusen, 2012 Mazzolini et al 2017, Dularif et al 2019). Based on these costs and benefits analysis, the economic model is an advocate of strict audits and high penalties to tax offenders so as to reduce tax non-conformity.

The general tax economic deterrence theory is aimed at discouraging taxpayers from evading tax, “in an attempt to seek an enforcement mechanism that can be complemented or substituted by the appeal to the citizen's tax morality” (Mazzolini et al 2017, Dularif et al 2019).

Studies have shown that the act of evasion is wide spread and common in almost all countries (Alm 2013). As noted earlier on, tax evasion is the unlawful or deliberate act with the intention of reducing the obligation to remit correct taxes. The thinking in the mind of the taxpayer when getting tangled with evasion activity is making the most of the probable convenience of the tax evasion stake. It is founded on evaluating the benefits which may be obtained if the evasion activity succeeded in contrast with the punishment that may be suffered in case of being discovered by the authorities (Chauke, Sebola 2016; Alm, 2013, Mazzolini et al 2017). With tax evasion, a taxpayer knowingly and willfully engages in unlawful ways to dodge tax payments. This involves having incorrect tax bases; claiming incorrect expenses; deliberate incorrect filing of the tax return and any other unlawful ways to minimize the tax bill (Schmdt & Schneder, 2007; Olivier & Honiball, 2008, Dularif et al 2019).

The theory of tax deterrence is based on compliance configurations grounded exclusively on the capacity to pay basis. The revenues together with related expenditure of the Government are dealt discretely and tax is centred on taxpayer's capacity to remit taxes. This originates from present wealth and present revenue. It is important to make sure that those who have the ability to pay the due taxes do so willingly, or else they must bear the consequence of the theory of tax deterrence (Chigbu, Eze & Ebimbowei, 2012; Zhou & Madikeni, 2013; Ortega & Sanguinetti, 2013 Mazzolini et al 2017, Dularif et al 2019).

Taxes computed and remitted are considered by taxpayers as a sacrifice. This brings to the question as to what needs to be each taxpayers sacrifice as well as how to measure such a sacrifice (Rai, 2004). What is most prevalent and frequently accepted code of justice or equity in the area of tax is that taxpayers need to pay tax to their administration depending on their capacity to do so (Bacom & Limereck, 2013; Dularif et al 2019). This then means that deterrence theory should be applied in instances when taxpayers intentionally remit incorrect tax. This concept is well summarized by Mazzolini et al (2017) who, quoting May and Torgler (2003) writes:

> It can therefore be argued and appears reasonable and just that taxes should be levied on the basis of the taxable capacity of an individual. In using this principle, it can be stated that if the taxable capacity of one person is greater than that of the other person, then a person who earns more should be asked and expected to pay more taxes in comparison with the one who earns less. It can further be argued that if the taxes are levied on this principle as stated above, then justice can prevail and be achieved. The tax burden will then be evenly spread based on the ability of the person to pay such taxes, even when taxpayers are not in favour thereof, they should be coerced. (p. 16)

The general tax deterrence model has for a number of years gone through several modifications, but it is still being seriously discussed in studies relating to compliance of income tax (Dularif et al 2019). There have however been some criticisms relating to it "as not being realistic in explaining taxpayer compliance, since it predicts a general substantial noncompliance beyond what is obtainable in reality" (Rethi (2012).  Even with the audits plus penalties, which are the main constituents of deterrence theory, non-compliance of tax has continued, resulting into loss of revenue to governments (Slemrod, Joel. 2019, Tilahun, 2019)). Besides, studies have also shown that there are taxpayers who are always compliant, never evading tax, even when the chances of them being audited are very low. Examples include the USA and the Scandinavian country (Williamson 2017). Studies there have disclosed very high level of tax compliance as Fjldstad, Schulz-Hezenberg and Sjursen (2012) puts it "… is more than what could be accounted for even by the highest feasible levels of auditing, penalties and risk aversion" (p. 27). These studies have resulted into some researchers to observe that considering what is happening on the ground relating to this theory, the real question concerning individual and corporate compliance must be "why people pay taxes" as opposed to "why people evade them" (Alm, 1999 and Slemrod, 2019).

Other than the limits observed on the preceding paragraph, this model is criticized as it does not take into consideration the behavior of tax payers like perceptions, judgements and attitudes (Lewis, 1982); for not taking into account the ethical constraints values which have the ability to prevent taxpayers from evading their rightful tax (Sour, 2004). This brings in the tax theory called Social Psychology as the second tax compliance deterrence theory which is now described below.

#### 2.2.3.2 Social psychology deterrence theory

Quite recently, Doerrenberg et al (2018) acknowledged that it is now generally accepted that the choice for tax evasion is motivated by a number of factors apart from the extrinsic economic impacts such as the rates of tax, tax penalties, probability of audit as well as tax prosecution, as observed under the general economic deterrence theory above. General economic deterrence alone has been unable to explain the very high levels of tax compliance in reality seen in several developed economies, especially in the west (Graetz 1985; Alm 1992; Frey 2002 Mazzolini et al 2017, Williamson 2017, Dularif et al 2019). Research has been faced with a big puzzle: in the developed world where the economy is at an advanced stage, tax compliance level is by far greater than that projected by economic deterrence concepts (Graetz et al, 1985 and Alm 1992, Williamson 2017). Just as Andreoni et al (1998) observed, the developed world is showing a much higher tax compliance which can’t be explained by the economic deterrence tools only, like tax audits and higher fines.

The social psychology deterrence theory is preceded on the basis that taxpayers formulate their behavioral intents based on two elements – their personal influences and their social effects (McKerchar & Evans, 2009). These two basic elements are commonly agreed to play vital roles in defining tax compliance levels (OECD, 2018). This is in agreement with the observation of Ronan and others (2007) who stated that elements like reputation, social standards and stigma have an important effect on client’s resolution as to whether to evade tax or not to.

OECD (2018) defines personality norms as “the deeply rooted convictions about what one ought or ought not to do” (p. 1). According to Franzoni (1999), “these personal convictions or norms are said to be hard to modify, not even within the reach of the public policy” (p. 4). This is because they take an elongated time of socialization activities to mature (OECD, 2018). Personal standards relate to taxpayers’ ethics, values mentality of tax, related and tax morale, as all these activities have an impact on taxpayers’ compliance. Involvement in schemes of tax evasion results in feelings of anxiety, guilt or negative self-image in the mind of taxpayers (Sour 2004). Being afraid of “social stigmatization” as one of the “factors deterring tax fraudulent activities confirms the conviction that in general, tax compliance is taking place in the social confines”

(OECD 2018, p. 3), as well as existence of what is to be termed the “social norms effect on tax compliance conduct. Alm (1999) defines social norm as “a pattern of behavior that is judged in a similar way by others and that therefore is sustained in part by social approval or disapproval”. An individual taxpayer will highly likely observe correct tax payments where his peers are compliant. Similarly, entities will comply fully with correct tax payments if related entities comply (Walsh, 2012; Ali, 2013, OECD 2018,).

### 2.2.4 Income tax compliance and its impact on financial performance of SMEs – key theories informing the study.

The relationship between income tax and financial performance of Small and Medium Enterprises (SMEs) is a complete and multifaceted area of study. This relationship between income tax compliance and the financial performance of Small and Medium Sized Enterprises is a subject of academic and practical interest. These theories of income tax compliance and financial performance of SMEs provide insights into the complex interplay between tax compliance behavior and the economic outcomes of these businesses. Understanding these theories can inform tax policies, enforcement strategies, and support mechanisms to promote both tax compliance and the financial wellbeing of SMEs.

Several theories and hypotheses have been proposed to explain how tax compliance behaviour can affect the financial outcomes of SMEs. Here are some key theories and prospectives that are often explored in this context: Tax compliance cost theory, tax behaviour and enforcement theory, tax planning and compliance theory, tax morale theory, tax evasion and avoidance theory and tax policy and financial performance theory.

The current study revolves around the following four key theories that help to explain income tax and financial performance of Small and Medium Enterprises (SMEs): Institutional theory, behavioral economics, tax complexity theory and tax morale theory. The study’s four key theries are briefly explained below:

#### 2.2.4.1 Institutional theory

Institutional theory is a framework used to understand how institutions, including legal and regulatory systems, shape individuals' and organizations' behavior (Scott 1995). This theory has been applied to the field of taxation to explore how tax compliance and tax policies are influenced by the broader institutional context. In the context of taxation, institutional theory helps us understand how the rules, norms, and regulations established by governments and tax authorities affect taxpayers' actions (Scott 1995).

Key concepts of institutional theory in taxation as per Scott (1995) include the following:
*Regulatory environment*: Institutional theory emphasizes that tax compliance is influenced by the formal and informal rules governing taxation. This includes tax laws, regulations, and the administrative practices of tax authorities. These rules define who is liable for taxes, what income or transactions are taxable, and the procedures for tax assessment.

*Norms and social pressure*: Social norms and peer pressure play a significant role in tax compliance. Taxpayers may conform to prevailing norms within their social and business circles, either encouraging or discouraging compliance. Tax payers' behaviour is often influenced by what is considered socially acceptable or unacceptable regarding tax obligations. These norms can vary across cultures and societies.
*Legitimacy:* Tax compliance is often motivated by a desire to maintain the legitimacy of an organization. Businesses and individuals want to be seen as legitimate members of society, which is closely tied to their willingness to comply with tax laws. The legitimacy of tax authorities and the tax system is central to tax compliance. When individuals and businesses perceive the tax system as fair, transparent and legitimate, they are more likely to voluntarily comply with tax obligations. Trust in institutions is a critical factor in encouraging tax compliance.

*Isomorphism:* Institutional theory suggests that organizations tend to mimic the practices of others in their environment. In taxation, this can lead to conformity in tax planning and compliance strategies within industries or regions.
*Enforcement deterrence*: The effectiveness of the tax enforcement procedures including penalties and audits is an integral part of tax institutions. A credible enforcement mechanism can deter tax evasion and promote compliance.
While Tax Institutional Theory provides valuable insights into the role of institutions in taxation, it is not without challenges and criticisms. Critics argue that the theory may oversimplify the complexities of tax compliance behavior and that individual motivations are influenced by a wide range of factors beyond institutions.

In conclusion, Tax Institutional Theory offers a comprehensive framework for understanding the profound impact of institutions on tax systems and tax compliance behavior. Recognizing the interplay between formal and informal institutions is essential for designing effective tax policies, fostering voluntary compliance, and maintaining trust in tax systems. This theory continues to be a valuable tool for policymakers, tax authorities, and researchers seeking to navigate the intricate world of taxation.

### 2.2.4.2 Behavioral economics

Behavioral Economics brings a nuanced perspective to SME tax compliance by examining the behavioral aspects of decision-making that impact financial performance. Recent studies emphasize how psychological biases and heuristics influence SMEs' tax compliance behavior and financial decisions (Fuest et al., 2021). The integration of behavioral insights has expanded the understanding of the complex interplay between cognitive factors and financial outcomes for SMEs. Recent research has explored how cognitive biases, bounded rationality, and heuristics influence SMEs' tax-related decision-making (Artavanis et al., 2020; McCaffery, 2020). SMEs may not always make tax decisions based on purely rational calculations, as behavioral biases play a role. In the context of taxation and SME financial performance, Behavioral Economics sheds light on how SMEs' behavioral tendencies impact their tax compliance behavior and, consequently, their financial outcomes.

Key aspects of behavioral economics

Cognitive biases: Recent research suggests that cognitive biases such as loss aversion, overconfidence, and mental accounting can lead SMEs to make suboptimal tax-related decisions (Artavanis et al., 2020). For instance, SMEs may prioritize short-term tax savings over long-term financial planning

Decision making heuristics: Behavioral Economics highlights how SMEs often use decision-making heuristics, such as anchoring and availability heuristics, when assessing tax compliance risks (McCaffery, 2020). These heuristics can result in biased perceptions of tax obligations and impact financial decisions.

Behavioral insights: Recent studies have applied Behavioral Economics insights to design interventions that promote tax compliance among SMEs. For example, nudges and reminders can influence SMEs' tax payment behaviors and, subsequently, their financial stability (Adena et al., 2019).

Impacts on SME financial performance

Behavioral factors have direct and indirect impacts on SME financial performance in the context of taxation. Recent research shows that SMEs with better tax compliance tend to have improved financial stability and reduced risk of penalties or legal disputes (Bertomeu et al., 2020). However, the relationship between behavioral factors and financial performance is nuanced. Cognitive biases and heuristics can lead SMEs to adopt suboptimal tax strategies, potentially affecting profitability. Therefore, understanding how these behavioral factors influence tax compliance is crucial for assessing their impact on financial outcomes.

Behavioral Economics theory provides valuable insights into the behavioral tendencies of SMEs in the context of taxation and their subsequent financial performance. Recent research underscores the importance of addressing cognitive biases and heuristics in designing effective tax compliance interventions for SMEs, ultimately contributing to their financial well-being

2.2.4.3 Tax complexity theory

Tax Complexity Theory acknowledges the ever-evolving landscape of tax regulations and its consequences for SMEs' financial performance. It emphasizes the challenges and costs associated with complex tax codes, regulations, and compliance procedures. In the context of taxation and SME financial performance, Tax Complexity Theory posits that high tax complexity can impose compliance costs on SMEs, which may impact their financial performance.

Recent research highlights the challenges posed by tax complexity on SMEs' profitability (Torgler, Benno 2021). Emerging topics, such as the digitalization of tax reporting, further influence the financial implications of compliance (Bhaskar et al., 2020). Recent studies have also examined the impact of tax complexity on SME compliance and financial performance

(Gjerde & Lohne, 2020; Auten & Gee, 2020). Complex tax regulations can increase compliance costs for SMEs, affecting their financial resources.

Key aspects of tax complexity theory

Complex regulatory landscape: Recent research has highlighted how tax codes, regulations, and reporting requirements have become increasingly complex (Bird & Zolt, 2019). High tax complexity means SMEs must allocate more resources to understand and comply with tax laws.

Compliance costs: Complexity in tax systems often results in increased compliance costs for SMEs. These costs may include expenses related to tax planning, legal advice, and record-keeping (Gjerde & Lohne, 2020).

Technological advancements: Recent studies have explored how technological advancements, such as the digitalization of tax reporting and payment systems, influence SME compliance costs and financial efficiency (Auten & Gee, 2020).

Impact on SME financial performance

Tax Complexity Theory suggests that high tax complexity can have direct and indirect impacts on SME financial performance. Recent research has indicated that: compliance costs associated with tax complexity can reduce SME profitability and financial resources available for investment (Gjerde & Lohne, 2020); complex tax regulations may lead SMEs to make suboptimal financial decisions, such as delaying investments or reducing workforce size to manage tax obligations (De Simone et al., 2019) and technological advancements that simplify tax compliance processes can mitigate the negative financial impacts of tax complexity (Auten & Gee, 2020). It is believed that the taxes together with a complicated tax arrangement, puts an unequal burden on small and medium enterprises. Tee1 et al (2016) further observed that there is discrimination against small and medium taxpayers which follow the same complicated tax system with fellow large entities, this is because the compliance needs, cost of compliance and rates of tax are all equal for big and small entities. Despite these observations in the developing world, the study takes the position that better tax compliance of SMEs is related to their long-term sustainability and growth, in line with OECD (2012) position. Thus, it can be stated that the more SMEs comply with their income tax obligations, the higher the sales and the higher the related profitability

Tax Complexity Theory underscores the importance of understanding how complex tax systems can affect SMEs' financial performance. Recent research highlights the negative financial consequences of high tax complexity, but also suggests that technological advancements can offer solutions to mitigate these impacts.

2.2.4.4 Tax morale theory.

Recent scholarship underscores the significance of Tax Morale Theory in understanding the ethical dimensions of SME tax compliance and its impact on financial performance. Studies reveal that tax morale influences SMEs' willingness to comply with tax obligations, ultimately affecting their financial stability (Cuccia & Guccio, 2021). Current research delves into how ethical considerations affect financial decisions and performance in the context of taxation (Wagner, 2021). Recent research has explored how SMEs' intrinsic motivation and societal norms influence their willingness to comply with tax obligations (Hagendorff et al., 2020; Cuccia & Guccio, 2021). High tax morale is associated with a sense of ethical responsibility in paying taxes

Tax Morale Theory explores the ethical dimensions of tax compliance, emphasizing the role of taxpayers' intrinsic motivation and societal norms in influencing their willingness to fulfill tax obligations. In the context of taxation and SME financial performance, Tax Morale Theory suggests that higher tax morale can lead to greater tax compliance, which, in turn, may positively impact SME financial outcomes.

Key aspects of tax morale theory

Ethical dimensions: Tax Morale Theory highlights the ethical considerations that taxpayers associate with tax compliance. Recent research has delved into the ethical motivations and perceptions of tax fairness among SMEs (Hagendorff et al., 2020).

Willingness to comply: Tax Morale is closely linked to taxpayers' willingness to voluntarily comply with tax laws. High tax morale can lead to proactive tax compliance behaviors (Torgler, 2003).

Societal norms: Recent studies have explored how societal norms and cultural factors influence tax morale among SMEs (Cuccia & Guccio, 2021). These norms can affect how SMEs perceive their ethical duty to pay taxes.

Impact on SME Financial Performance

Tax Morale Theory suggests that high tax morale among SMEs can have both direct and indirect impacts on financial performance:

Direct impact: SMEs with higher tax morale are more likely to comply with tax obligations, reducing the risk of penalties and legal disputes, which can positively impact their financial stability (Auten & Gee, 2011). Personal norms relate to taxpayers' ethics, tax values, tax attitude, and tax morale, these have a bearing on taxpayers' compliance. It can therefore be theorized that involvement in schemes of tax evasion results in feelings of anxiety, guilt or negative self-image in the mind of taxpayers. Being afraid of societal stigmatization as one of the factors deterring tax fraudulent activities confirms the conviction that in general, "tax compliance is taking place in the social confines" as well as existence of what is to be termed the "social norms effect on tax compliance conduct" (Kirchler, 2007, p. 4). SME taxpayers are likely to observe correct tax payments where their tax morale is high, for example, where they have trust in their national Government and are happy with the way they perceive that their national Government spends their tax money, where they perceive overall low tax evasion in the industry, where they perceive that they are highly regarded in society and where they perceive that the current income tax system is not burdensome on their SME entities and vice versa.

Indirect impact: High tax morale may lead to a sense of ethical responsibility and integrity in SMEs' overall business practices. This can enhance their reputation, customer trust, and long-term financial performance (Wagner, 2021).

Moderating role: Recent research has explored the moderating role of tax morale in the relationship between tax complexity and SME financial performance. Higher tax morale may help SMEs navigate complex tax systems more effectively (Cuccia & Guccio, 2021)

Tax Morale Theory underscores the importance of understanding the ethical dimensions of tax compliance among SMEs and its potential impact on their financial performance. Recent research highlights the multifaceted relationship between tax morale, compliance behavior, and financial outcomes, emphasizing the need for a comprehensive understanding of these dynamics

## 2.3 General conceptual issues of Taxation

### 2.3.1 Definition of tax

Different definitions of tax are coined by different writers. For example, tax has been defined as "a compulsory, unreciprocated payment to general government made by either individuals or entities to government entities" (OECD 2018, p. 248). This definition is in agreement with that given by Olufemi et al (2018) who, quoting Nightingale (2001), defined tax as "a Compulsory Contribution, imposed by Government" (p. 73) and while taxpayers may receive nothing identifiable in return for their contribution, they nevertheless have the benefit of living in a relatively educated, healthy and safe society. The definitions of the tax above are all in agreement with that given by other local tax experts in Malawi, like that of Mughogho (2014), who defines tax as "obligations made by governments on the income and wealth of persons under their jurisdiction" (p. 14). A synonym to the term "obligation" is "compulsion", giving the same "compulsory payment connotation as observed in the international definition above. The term Persons in this case represents both individuals and entities".

Taxes are said to be "obligatory charges on persons or organizations by governments". In contemporary economies, taxes form a key foundation of income to the Governing Administration (OECD 2018, p. 248).

Taxes are different from other bases of income because they are obligatory charges and they are unreciprocated, for example, they are not paid in return to some form of related return, like a specific service from the public. Taxes are ostensibly obtained for the benefit of all taxpayers and distinct taxpayer's obligation is not dependent on any precise advantage obtained (Mughogho 2014).

Although taxes are compulsory payments, it needs to be noted that it is not true that all compulsory remittances to the Malawi Government comprise of tax. Pension contributions in the country are compulsory in every sense of the word, at the rate of 10% of the employee's salary, when some minimum conditions are satisfied considering that employers and organizations are not given any choices as to whether to contribute or not. This cannot be said to be a form of tax.

Taxes are considered as unreciprocated since the governing entities do not provide anything in return to the individuals and entities giving the payment. This is despite the fact the Government can use the same collected money to offer services or goods “to other units, either individually or collectively, or to the community as a whole” (OECD 2018, p. 248).

### 2.3.2 Purpose of Tax

Merima et al., (2013) quoting Drummond et al., (2012) observed that many sub-Saharan countries consider tax as a source of national revenues as a key priority. This is because collecting taxes results into these African Governments to craft fiscal space and offer important public amenities, in the process, hopefully cut down on external aid as well as dependence on few sources of income. This means that the charging of taxes and tariffs aims at raising revenues to fund Governments or affect prices of goods and services so as to impact on related demand.
Throughout history, countries have employed tax money obtained through the tax system to many uses, including payments on communal infrastructures like “roads, public transportation, sanitation, legal systems, public safety, education, health-care systems, Agriculture, military, scientific research, culture and the arts, public works, distribution, data collection and dissemination, public insurance, and the operation of government itself” (Merima et al. 2013). In developed economies, governments have used tax for purposes other than simply economic uses. Musgrave and Peacock (1958) distinguish amongst purposes of “resource distribution, income redistribution, and the stability of the economy”. According to Musgrave and Peacock (1958):

> Economic growth or development and international competitiveness are sometimes listed as separate goals, but they can generally be subsumed under the other three. In the absence of a strong reason for interference, such as the need to reduce pollution, the first objective, resource allocation, is furthered if tax policy does not interfere with market-determined allocations. (P. 42)

According to Olefumi et al (2018), the following are the key reasons for taxation: delivery of goods to the public, redistribution of wealth and income from the rich to the poor and promotion economic and social stability as well as synchronization and regulation.

It is stated that SMEs play important roles in almost all economies, both developed and developing, as a source of tax. Tax is a vital source of revenue for any country (Obara & Nangih, 2016). Taxation is a stable source of income to the government. Taxation helps the government to achieve their developmental goals (Obara & Nangih, 2016). SMEs function as "providers of employment, contributors to Gross Domestic Products, technological development, redistribution of a nation's wealth, elimination of poverty, reduction in rural-urban drift, change in a monolithic economy" (Obara & Nangih, 2016, p. 35). Olufemi A Aladejebi (2018) quotes Atawodi & Ojeka, (2012), that those who manage the economies of nations should strive to adopt tax strategies and policies which boost savings and excite investment. The money generated from taxes should be used to provide infrastructure, create employment, diversify the economy, encourage local industries, promote exports. The best way of generating funds internally for any Government is through taxation (Atawodi & Ojeka (2012), Obara & Nangih (2016), Olufemi (2018).

Tax has an essential contribution to the generation of revenue to nations globally (Obara & Nangih, 2017, Olufemi (2018). Tax policies should encourage SMEs to make enough profit so that they can expand.

Many SMEs are said to choose to remain in the informal sector. This is because they think the benefits outweigh the costs of moving to the formal sector (Amanamah, 2016).

The aim of the reallocation of revenue is to reduce imbalances in society. This stabilization objective which is executed by way of taxation strategy, government spending plan, money plan, and debt administration is aimed at keeping employment high and price stable.

There are however possible "clashes among the above three purposes of the tax regime. As an example, resource re-allocation may need variations in nature or configuration or both of taxes, however, such changes are likely to have a strong negative bearing on low-earning people, thus hurting redistributive objectives of taxation" (Obara & Nangih, 2017, Olufemi (2018). An additional example, taxes which are "re-distributive are likely to be in disagreement with the effectual purpose of wealth allocation needed to attain financial impartiality" (Obara & Nangih, 2017, Olufemi (2018).

According to IMF (2011) and ITD (2012), internal income tax collection in many nations in Africa is challenged with extensive taxation evasion as well as avoidance in most African countries, which in turn has a negative impact on what Chand et el. (2018), calls economic efficiency and income distribution, implementation and outcomes of economic policies and government's legitimacy. Smith (1776), an acknowledged social scientist made the following statements in relation to tax:

> Such things as defending the country and maintaining the institutions of good government are of general benefit to the public. Thus, it is reasonable that the population as a whole should contribute to the tax costs. It is also reasonable to demand certain other things of a tax system – for example, that the amounts of tax individuals pay should bear some relationship to their abilities to pay ….good taxes meet four major criteria. They are (1) proportionate to incomes or abilities to pay (2) certain rather than arbitrary (3) payable at times and in ways convenient to the taxpayers and (4) cheap to administer and collect.

### 2.3.3 Categories of taxes

The taxation system of any nation is a fundamental component of its fiscal policy, serving as a critical mechanism for revenue generation and economic governance. In the case of Malawi, a landlocked nation located in southeastern Africa, the structure of its tax system plays a pivotal role in sustaining government operations and financing public services, infrastructure development, and socio-economic programs (Bwalya, 2016; Malawi Government, 2020)

Taxes are classified in many ways in line with factors such as "who pays for them, the degree to which the problem may be moved, as well as several other conditions. Taxes are categorized into two: direct or indirect taxes. Vazquez et al (2009) defines direct tax as those that may be adjusted to the specific features of a taxpayer and indirect tax like the one which is charged to trades regardless of the condition of individual buyers or sellers. Hence income taxes are categorized as direct taxes and the same can also be said for taxes on wealth, for as long as there are probable changes for the features of proprietors. As an example, chattel taxes on self-owned houses may be attuned for particular individual features of proprietors. Tax on properties held for commercial purposes, cars, together with related assets are rarely adjusted for individual or domestic features and hence they may be taken as indirect taxes. It can therefore be stated that these are taxes in transit"; precisely, a general value-added tax, also called sales tax.

Malawi's tax system encompasses a range of categories, each with its own specific features and objectives. These categories serve as diverse avenues for revenue collection and are designed to promote economic stability, equity, and social progress (Bird & Bird, 2018). Understanding the intricacies of these tax categories is paramount for both policymakers and researchers, as it informs fiscal decision-making, assesses the impact on the economy, and provides insights into potential reforms (Banda, 2019).

The primary tax categories in Malawi typically include:

#### 2.3.3.1 Direct taxes

Direct taxes "may be attuned to specific features of taxpayers while indirect tax is the type which is charged to trades regardless of the condition of individual buyers and sellers (Vazquez et al 2009 (Gbato 2017). These are mainly taxes levied on ordinary individuals, and are characteristically grounded on the ability of the taxpayer to pay in relation to their earnings, consumption and net income. Direct taxes are usually charged at progressive rates, implying that as income rises, so does the rates. Unlike indirect tax on expenditure, for example, Value Added Tax (sales tax), direct consumption taxes are accustomed to a person's capacity to pay in relation to marital status, age, dependents number", and so on (Vazquez et al 2009).

#### 2.3.3.2 Indirect taxes

Indirect taxes are defined by Vazquez et al (2009) and Gbato, (2017) as "that which is collected on trades regardless of the condition of individual buyers or sellers. Indirect tax is charged on production as well as the consumption of merchandise and service. An example of indirect tax is sales tax, sometimes referred to as value-added tax (VAT). An identical rate of tax may be used on taxed goods and services. Indirect taxes are accessed by consumers through intermediaries. As Young (2020) puts it, an indirect tax "is collected by one entity in the supply chain, usually a producer or retailer and paid to the government, but it is passed on to the consumer as part of the purchase price of a good or service". It can be stated that it is the final consumer of the product or service who ultimately pays the indirect tax. This tax is "capable of being shifted by the one paying tax to another person. This tax can escalate the selling price of goods or services to the extent that consumers are essentially paying more tax by consuming more of the taxed product. Some key indirect taxes in Malawi include customs duty; excise tax and VAT. Customs Duties are enforced on products that are imported to a country. The main aim of customs duty is to safeguard the nation’s economy and jobs, by regulating the movement of imports, mainly bad and barred goods. In simple terms, this tax is executed on both importation and exportation of goods. Excise duty is levied on excisable goods which are made in Malawi and are to be consumed internally. Value-added tax is projected market price added onto a product at every phase of its production or marketing, the cumulated price is finally passed onto the final shopper”. This is a many-point charge on every single entity in the supply chain.

### 2.3.4 Principles of Tax

The principles of taxation form the foundation of a country's tax system and play a pivotal role in shaping revenue collection, economic governance, and the distribution of public resources. In Malawi, a landlocked nation situated in southeastern Africa, understanding the principles that guide the tax system is paramount for policymakers, researchers, and citizens. These principles not only underpin the legality of the tax system but also influence tax policy, revenue generation, and economic stability (Bwalya, 2016; Malawi Government, 2020).

The principles of tax in Malawi encompass a set of fundamental guidelines and concepts that govern the country's approach to taxation. These principles are instrumental in ensuring fairness, efficiency, and transparency in the collection and utilization of public funds. A comprehensive understanding of these principles is vital for the effective operation of the tax system and the attainment of national development goals.

According to Loukianova (2021), the subject matter "Fundamental Principles of Tax” is the study of “the essence of tax as an economic category of modem states, their place and role in economic policy at different stages of the historical development of the states, the study of the evolution of the doctrine of taxes and taxation”. This area of study is about concepts such as “public goods, public finance, tax, tax system, tax regulation, tax mechanism, fiscal policy” (Loukianova, 2021). According to Hanneke du Preez (2018), principles of tax were used as far back as the year 4000 BC. The “design of acknowledged principles of tax started officially with a known economist of the time, Adam Smith, in the year 1776. According to Hanneke du Preez (2018), Adam Smith called these four the four maxims of taxation. These principles articulated by Adam Smith were based in his interpretations and individual understandings of the world then.

Adam Smith, the well-known 18th-century social scientist and economist had long outlined the directives that must oversee a good tax scheme. Adam Smith (1776) classified into four what he termed as canons of taxation. The tax canons are characteristics of a noble scheme of taxation. Identified canons comprise of: equity; certainty; convenience and economy.

Equity canon demands "that any respectable structure of taxation must be arranged in such a manner which makes application and implementation fair to taxpayers (Smith 1776). The taxation system needs to be arranged in such a way that the citizens of the country have the ability to pay. According to Smith (1776), there are several interpretations as to what fairness of sacrifice means, however, a more progressive type of tax is usually deemed fair" for the reason that the amount of tax to be corrected is proportionate to the amount of income.

Certainty principle says that "as tax liability arises, the tax administrators must be certain or sure regarding the amount of taxation needed to be received. The theory of convenience requires payment to be in line with the timing of revenue. As an example, the Value Added Tax (VAT) gets collected when an organization makes a sale and an invoice is raised and Pay As You Earn (PAYE) gets collected as an emolument gets paid or accrued in the accounts. At each stage above, the tax-payer is certainly sure of the quantum of tax to be paid. The principle of economy is about the cost related to the collection of tax". It should be economical to collect the tax. As (Smith 1776) puts it, the cost of collecting tax must be lower than the benefits accrued to it

Other tax principles or canons identified by Smith (1776) are Flexibility, simplicity and diversity. The theory of flexibility requires suppleness and flexibility whenever a new tax structure is implemented in reaction to changing environment. Any good scheme of tax must have flexibility. The simplicity theory requires a worthy tax system to be as simple as possible. Diversity theory requires the key revenue sources for any Government to be wide as opposed to being narrow" (Smith 1776). Smith (1776) gave a piece of advice to Governments: have several sources of tax.

A 2012 World Bank study in Malawi observed that "there were seven hundred and sixty thousand (760,000) SMEs in Malawi, mostly concentrated in the only four cities of Malawi, namely, Blantyre, Lilongwe, Mzuzu and Zomba". It can be stated that Malawi has SMEs as the majority of its industries".

### 2.3.5 Distribution of tax burdens

Administrative forces, ideologies and aims are capable of making a governing administration take a particular course of taxation policy. Below is a discussion of key philosophies which can shape choices concerning tax distribution.

#### 2.3.5.1 Horizontal equity

This principle stresses that similarly placed persons be subjected to similar tax responsibilities (Elkinst 2006**).** Horizontal equity refers to the idea that people in the same circumstances should be treated in the same way. Vertical equity denotes to the idea that people on higher incomes should take on a greater share of the responsibility for paying for public services. It can be stated that if similar treatment is given to persons in a similar situation, for example, if each of the two earns 10,000 then each one should pay the same amount of tax of, say, 2,000.
It can be argued that horizontal fairness makes sure there isn't discrimination amongst taxpayers on the basis of such things as color, race, gender and type of work. Horizontal equity tax structure doesn't offer any special treatment to some persons or entities.
According to Elkinst (2006), horizontal equity is revealed as a serious error in any anticipated taxation arrangement. Questions are asked as to why tax policy makers seek to enforce comparable tax measures on similarly comparable taxpayers. Generally, academics take it as usual that taxation scheme must treat tax-payers situated similarly in a similar manner, and their attention is instead turned to principle implementation: how to measure well-being, or if the horizontal equity is violated by some provisions of a tax arrangement. What is key is that horizontal equity mainly deals with persons that are similarly situated, not with those who are identically situated. Reiteratively, any conceivable tax arrangement will treat identically situated taxpayers equally.

If the tax burden, for instance, falls more heavily on one group of taxpayers because their income, consumption patterns, marital status or place of residence is different than those of another group, then, by definition, the members of the two groups are not identically situated. Taxpayers are similarly situated when their situations are considered to be equivalent. While identically situated taxpayers are always similarly situated, similarly situated taxpayers are not necessarily identical. If, for example, savers and consumers are similarly situated, horizontal equity demands that they face equal tax burdens despite their different circumstances. The fact that the tax system treats taxpayers similarly does not, of course, mean that they are similarly situated. Every tax respects horizontal equity in terms of its own base: a tax based on shoe size imposes an equal burden on all taxpayers who wear the same size shoe. For horizontal equity to be an effective tool of tax theory, it needs to be understood as requiring that equally well-off taxpayers be taxed equally (Elkinst 2006).

Consumption tax advocates assertion that horizontal equity is violated by the income tax since income does not measure accurately the well-being of a taxpayer.

2.3.5.2 Ability to pay principle

This code observes that every taxpayer ought to pay related tax to their governing administration in consideration of their capacity to remit taxes (Rai et al 2004; Chodorow, 2008; Batt, 2012). It can therefore be stated that the implication of this theory is for rich persons to have the morality of paying more to their nations, because without the protection of the government authorities like police and defense, they could not have earned and enjoyed their income that they enjoy.

Adam Smith contended that tax payments by tax payers must be relative to the revenue earned (Rai, 2004; Chodorow, 2008; Batt, 2012). For that reason, it can be stated that this is one of the critical principles of tax since it promulgates for the tax system to offer fairness in its application, wherein those who have the financial resources and the ability to pay should make the payment in line with their ability. The "ability to pay theory propagates that people should be asked to pay taxes according to their ability to pay and assessment of their taxable capacity should be made primarily on the basis of income and property" (Chigbu, Eze, and Ebimobowei 2012 p. 37). For that reason, it can be argued that in cases when the low-income earners pay tax, that negates the principle of equity as envisaged by Smith (1776) and it further widens the gap between the rich and the poor in the society, consistently further isolating comprehension of the revenue distribution which a good system of tax strives to attain. It can be stated that this theory is confirmed in Malawi by the practice of handling poverty-stricken suburbs of the cities differently from the wealthy ones by way of giving them a certain amount of electricity and water free. It can also be argued that indirect taxes like Value Added Tax in Malawi are in certain instances modified to the ability to pay norm, though restricted to some degree, for instance, by sparing from Value Added Tax necessities like certain low quality washing soap tablets as well as maize flour which is the staple food" for the majority of the population in Malawi.

2.3.5.3 The benefit standard

The benefit code positions that taxes remitted by a taxpayer ought to be correlated to the benefit the tax customer obtains from their state. It can, however, be stated that the moral appeal of this principle is not clear. If a taxpayer's tax must be linked to the benefits obtained from public services and goods, some questions can be asked, for example, what is the nature of this relationship? (Obara & Nangih, 2017, Olufemi (2018). It can be stated that the benefits principle is secured on the basis of competence. Alternatively, if one ignores the benefits which taxpayers enjoy when consuming such services and goods, equivalent sacrifice totally disregards, as Chigbu et al (2012) puts it, the question of whether or not the consumption of publicly provided goods and services are efficient, as well as the question of how these benefits affect the burden imposed by a tax. Chigbu et al (2012) makes the following statement:

> After all, if one taxpayer benefits more than another from the expenditure of tax revenues, it would seem appropriate to consider that benefit in determining each agent's tax burden. The benefit principle is utilized most successfully in the financing of roads and highways through levies on motor fuels and road-user fees (tolls). Payroll taxes used to finance social security may also reflect a link between benefits and "contributions," but this link is commonly weak, because contributions do not go into accounts held for individual contributors (p. 35).

Mill justified ignoring the benefits from the government expenditures by arguing that this benefit necessitates locating definite principles on issues essentially undefined, and taking them as a measure of concrete deduction. The public service is a typical diagnostic tool, with the preferences of public goods agents defining what distribution of resources among the public and private sector is effective, a key worry of economists nowadays. It can be said that the fact that each of these directions covers somewhat what the other does invites some sort of synthesis of the two. An example of such fusion is a shift towards equal benefits situation; meaning, expenditures and taxes may be designed in such a way that the advantage amongst agents is the same. Consequently, if the advantage of the delivery of communal services and goods increases as income increases, it will be hard to contend that redistribution towards lower-income tax-payers has taken place. It should be stated that there is a significant custom of employing taxes for the purpose of income redistribution.

#### 2.3.5.4 Economic efficiency

According to Fjeldstad et al. (2012), the consequence of tax on financial and monetary performance is significant for the following reasons: In the first instance, the "behavioral response of taxpayers affects the revenue consequences of changes in tax rates and tax rules. Second, the effects on economic efficiency or deadweight loss depend on tax payers compensated behavioral responses", i.e., on the behavioral effects excluding pure income effects. And, third, behavior is important for understanding the short–run macroeconomic consequences of tax changes on aggregate demand and employment.

The aim of the concept is for a tax system that is neutral. Taxpayers are expected to behave as if tax does not affect their consumption behavior, hence the aim for a government is to generate a taxation system which doesn't influence behavior of taxpayers, for example by working less, saving less, selling or buying less, than they would have otherwise. Planning a system of tax which doesn't create unfairness for some class of people, is the main purpose of neutrality code. According to Fjeldstad et al. (2012):

> There are instances to the contrary where economists largely believe that markets do a fairly good job in making economic decisions about such choices as consumption, production, and financing. Thus, they feel that tax policy should generally refrain from interfering with the market's allocation of economic resources. That is, taxation should entail a minimum of interference with individual decisions. It should not discriminate in favor of, or against, particular consumption expenditures, particular means of production, particular forms of organization, or particular industries. This does not mean, of course, that major social and economic goals may not take precedence over these considerations. It may be desirable, for example, to impose taxes on pollution as a means of protecting the environment. (p. 78)

For the effective management of taxation laws, there are four broad necessities and these are precision, steadiness, cost-effectiveness, and accessibility. Organizational contemplations are particularly significant to underdeveloped nations, where level of illiteracy is high and there is the absence of accountability, markets, and inadequate resources could impede both administration and compliance.

#### 2.3.5.5 Clarity

Taxation laws together with related rules and principles "should be coherent and understandable to taxpayers; meaning, they should be as straight forward and as clear-cut and definite to both the tax-payer and the revenue Authority. It can however be argued that tax laws of Malawi and many other countries are obscure and difficult to be grasped by the taxpayers. It can also be argued that this lack of clearness results in much error and unintentional irregularities on the part of taxpayers. It also dwindles trustworthiness and reverence for the underlying tax law as well as inclines to differentiate against the uninformed and the underprivileged who do not have the ability to take benefit of the available tax planning prospects to the sophisticated" and the well-off citizens.

#### 2.3.5.6 Stability

Tax rules and regulations should not be altered frequently, and if such changes are done, there is a need for them to be done in the context of a general and systematic tax reform, with adequate provisions for a fair and orderly transition. It can however be argued that the tax laws of Malawi and most counties of the world change on a frequent basis, with inadequate provisions for methodical evolution. It can also be argued that rapid changes to tax rules and regulations have the consequence of reducing tax compliance.

#### 2.3.5.7 Cost-effectiveness

Cost of evaluating, gathering, and directing taxes must be in line with the goals of taxation and must be kept low. It can be argued that this standard is not important in advanced nations, but in emerging nations, where funds required for administration and compliance are rare. It can also be argued that fairness and financial prudence must not be forfeited for cost respects. Minimized costs include those of the taxpayer, government and private agents like companies which are entrusted with tax collections on behalf of the Government.

### 2.3.5.8 Convenience

There should be convenience regarding remittance of tax by tax-payers. In other words, tax payers should not find it extremely difficult to remit computed taxes. Governments frequently permit remittance of big tax obligations in periodic instalments and also offer substantial unlimited time for completion of tax returns.

### 2.3.5.9 Economic goals

The main aim of a country's taxation scheme is to collect revenue for the purpose of paying government expenditures. It is argued that public expenses grow as fast as the national product, taxes, as the main vehicle of government finance, should produce revenues that grow correspondingly. This is because "collecting taxes results into these African Governments to craft fiscal space and offer important public amenities, in the process, cut external aid as well as dependence on few sources of income" (Obara & Nangih, 2017, p. 33). This means that the charging of taxes and tariffs aims at raising revenues to fund Governments or affect prices of goods and services so as to impact on related demand. Throughout history, countries have employed tax money obtained through the tax system to many uses, including payments on commercial infrastructures like "roads, public transportation, sanitation, legal systems, public safety, education, health-care systems, Agriculture, military, scientific research, culture and the arts, public works, distribution, data collection and dissemination, public insurance, and the operation of government itself" (Merima et al. 2013).

Taxation policy can be employed in promoting stability of the economy. Variations in tax liabilities not matched by changes in expenditures cushion cyclical fluctuations in prices, employment, and production. Built-in flexibility occurs because liabilities for some taxes, most notably income taxes, respond strongly to changes in economic conditions. A more-active approach calls for changes in the tax rates or other provisions to increase the anti-cyclical effects of tax receipts.

Some economists propose tax policies to promote economic growth. This approach may imply a qualitative restructuring of the tax system (for example, the substitution of taxes on consumption for taxes on income) or special tax advantages to stimulate saving, labor mobility, research and development, and so on. There is, however, a limit to what tax incentives can accomplish, especially in promoting economic development of specific industries or regions. An emphasis on economic growth implies the need to avoid high marginal tax rates and the tax-induced" deviation of incomes to comparatively fruitless actions.

2.3.5.10 Consolidation and imposition of tax compliance

The general scheme of any tax collecting authority ought to be to "inspire voluntary means whenever probable, as well as to enhance such levels of compliance using whatever ways possible (Oladele et al 2019, p. 22). It can however be said that not all tax-payers are prepared to conform fully to the taxation laws, and even those who do sometimes comply are unlikely to remain so all the time. According to Oladele et al (2019), most taxpayers travel up and down their pyramid of compliance, or assume varying situation on the compliance non-compliance continuum, for a variety of reasons". Oladele et al (2019) suggests that the "revenue authorities should then possess several tools, progressive in harshness, to tackle the non-compliance issue. The tools must not only be enforced, but must be seen to be enforced equitably", relative to severity of risk (Oladele et al 2019, p. 28).

Oladele et al (2019) quotes OECD to have acknowledged several schemes that "increasingly worsen the level of agreements which include standardized communications informing taxpayers that the date and data stated in their records does not seem to be usual for the nature of business they are in, or does not seem to include all probable income from their customers and walk-ins or un announced appointments to their business premises" (p. 28). It can therefore be stated that un-announced visits will give the authority a chance for a speedy checking of basic details and documentation like business registration, record keeping as well as other essential reporting necessities such as sales summaries which concentrate on the incomes of an organization, initiation, recording, processes, professional dealings, matching of procurements together with related sales.

According to Oladele et al (2019), another issue is comprehensive audits. These are "in-depth investigations seeking to identify the omission of income or overstatement of expenses, usually across more than one reporting period" (p. 28); serious evasion audits. Such audits may involve a range of compliance checks and lead to relatively higher penalties; and prosecution for cases of non-compliance involving large sums, persistent evasion or criminal activity. According to Mckerchar and Evans (2009), some commentators suggest that a dedicated tax fraud unit should be established to tackle such cases, as it requires special skills including knowledge of the tax fraud legislation, knowledge of the courts and appeals systems, and law enforcement expertise and ability to liaise with other governmental offices. This appears to be a better idea than the introduction of a separate Tax Police introduced in some Eastern European and South American regimes which has a sub-optimal effect as it artificially splits tax law enforcement between two organizations". Gill (2003) noted that "this is perhaps still the weakest area in revenue administrations in most developing countries. It is therefore an area that deserves closer attention, by reference to specific further strategies involving registration, verification, investigation and sanctions" which can make sure that "the revenue authority put in force compliance efficiently, effectively and economically".

## 2.4 General economic tax deterrence: Current literature.

### 2.4.1 Introduction

Tax deterrence is a critical concept within the field of economics and taxation, encompassing the study of factors influencing compliance behavior and the efficacy of tax collection. In Malawi, a landlocked nation in southeastern Africa, the principles of tax deterrence play an instrumental role in shaping tax policy and administration, revenue generation, and economic development (Mlozi & Mwamlima, 2020; Government of Malawi, 2015).

For emphasis, general economic tax deterrence refers to the broader economic factors that influence taxpayer behavior and the overall compliance with tax obligations. In the context of Malawi, a comprehensive understanding of general economic tax deterrence is essential for policymakers, researchers, and tax authorities. It provides insights into the economic conditions and incentives that encourage or discourage tax compliance, thereby affecting the fiscal stability and socioeconomic development of the country.

The question as to why people pay taxes has a number of answers. The most important and obvious of which is the existence of prosecution instruments, like fines together with related penalties from tax authorities (Ortega & Sanguinetti 2013). Using this type of tax model, taxpayers make a decision as to whether and to what extent must taxes be evaded, using the same way they would approach any risky decision or gamble, that is, by maximizing expected utility (Ortega & Sanguinetti 2013). In this context, it can be said that using evasion of tax is adversely related to the likelihood of discovery as well as the harshness of the possible penalty. This study adopts Devos (2007) definition of what he terms as “deterrence by punishment”. as a way of reflective intrusion “by holding out threats that whenever a wrong has been actually committed the wrongdoer shall incur punishment” (p. 77). It applies to cases where an actual or perceived threat from the tax man makes a taxpayer (make him to do what? It looks there is a word or two missing here) who would otherwise have made the perceived or susceptible conduct to abstain from engaging in the same.

The deterrence theory adopts that taxpayer’s compliance behaviors get swayed by fundamentals which include tax rates - these define the benefit of evading tax, together with penalties relating to fraudulent tax behavior and likelihood of being detected, which decides costs. This model takes a taxpayer “as a rational economic agent, who assesses the costs (determined by probability of detection and penalties for fraud) and benefits (determined by tax rate) of evading taxes, and hence chooses non-compliance, where the perceived costs of complying are higher than those of non-compliance” (Walsh, 2012). This model condenses the issue of non-compliance to the following “of rational decision making under uncertainty whereby tax evasion either pays off in terms of lower taxes or subjects one to sanctions” (Fjldstad, Shulz-Hezenberg & Sjusen, 2012, p 27). This means that “where there is a lower chance of tax audits and a low probability of penalties related to tax misbehavior, there will be a higher probability for tax evasion. Conversely, where likelihood of tax audits is high which will result into higher likelihood of detection together with related serious penalties, very few taxpayers will dodge taxes (Fjldstad, Schulz-Hezenberg and Sjusen, 2012). Based on these costs and benefits of adhering to tax laws, the economic model is an advocate of strict audits and high penalties” to tax offenders so as to reduce tax nonconformity.

According to the International Monetary Fund (2016), the best way to deal with income tax noncompliance is the same as highlighting tax deterrence as the way in which revenue collection can be improved. The taxpayers always makes a clear choice since they decide how much needs to be evaded in comparison to the income tax actually saved as well as any risk of being detected and subsequently penalized (Frey & Feld, 2002; Sandmo, 2004; Chauke & Sebola 2016). It can be argued that in doing this, the taxpayers' tests the likelihood of being discovered in their wrongdoings and at what cost will that be and make a resolution if they could sustain such punishment and, consequently place the conclusion on the same (Chauke & Sebola 2016).

Key facets of general economic tax deterrence in Malawi typically encompass:

Economic conditions: The state of the national economy, including economic growth, inflation, and employment levels, significantly impacts taxpayer behavior. An economic downturn may lead to reduced tax compliance due to financial hardship, while economic growth can boost compliance (Mlozi & Mwamlima, 2020).

Tax rates and incentives: Tax rates, deductions, and exemptions have a direct impact on taxpayers' decisions to comply. High tax rates can discourage compliance, while incentives, such as tax credits for certain activities, can encourage compliance (Banda, 2019).

Enforcement and penalties: The effectiveness of tax enforcement and the severity of penalties for non-compliance play a vital role in general economic tax deterrence. A strong enforcement regime and severe penalties can deter tax evasion (Malawi Revenue Authority, 2020).

Public perception and trust: Public perception of the fairness, transparency, and efficiency of the tax system can affect tax deterrence. A lack of trust in the tax authorities may lead to non-compliance (Government of Malawi, 2015).

Informal sector activity: The prevalence of informal economic activities can impact general economic tax deterrence. Informal sector participants often evade taxes, affecting revenue collection (Bird & Bird, 2018).

Economic activities: Government economic policies, including fiscal and monetary policies, can influence tax deterrence. Policies that promote economic stability and growth can contribute to tax compliance (Malawi Government, 2020).

Comprehending these factors is essential for crafting effective tax policies, tax administration strategies, and compliance incentives in Malawi. Research into general economic tax deterrence delves into the interplay of these factors, their impact on revenue collection, and their implications for economic development. It provides a foundation for assessing the effectiveness of the tax system and identifying opportunities for policy reforms that can enhance fiscal sustainability and economic growth

A more comprehensive review of the literature on general economic tax deterrence in Malawi is critical for policymakers, economists, researchers, and students to gain insights into the functioning of the country's tax system, evaluate its alignment with general economic deterrence principles, and identify opportunities for reforms that can contribute to economic development and fiscal sustainability (Malawi Government, 2020). It provides the foundation for more in-depth investigations into the specific aspects of each factor and their implications on the broader economic landscape in Malawi

### 2.4.2 General deterrence instruments: Some recent literature in Malawi, Africa and beyond

Effective and efficient tax management plays a key role in creating tax revenues for governments to deliver basic services which would increase the living standards of citizens. Delivery of decent wellbeing, infrastructure and preservation of good standards of citizens can be difficult in the absence of the backing of appropriate revenue inflows (Anyaduba, Eragbhe & Kennedy, 2012).

The widening tax gap is a key constraint to tax collectors. A gap in tax is defined as the variance between the tax actually remitted willingly in a timely manner and the genuine tax obligation which would have been remitted over the same period of time if the taxpayer was faithful (John, Emmanuel & Modugu, 2012). In the strictest sense, the level of tax revenue earned by the administration to achieve its budgetary objectives is dependent on the extent of compliance as well as how effective its prosecution implements are like (Alabede et al 2011).

Existing works, more specifically in the developing markets, have established that many taxpayers aren't compliant with tax requirements due to trust issues and every now and then due to lack of ability to meet some responsibilities (Oyedokun, 2015). According to the study of Kirchler (2007), tax noncompliance can be in the form of never filing the tax returns or filing tax returns late, misstating the allowable expenses and misstating the income – all with the intention of paying less tax.

Unsurprisingly, a number of studies have acknowledged that a number of taxpayers who partially complied may have done so simply due to probable penalty which would rise if liability comes subsequent to the tax audit (Nyaga, 2014; Oyedokun, 2015). Over and above, some taxpayers are compliant due to the fear of the probability of being audited (Anyaduba & Mogudu, 2013; Ladi & Henry, 2018).

Oyelade (2017) observed the low taxation compliance in Nigeria as repulsive and widespread due to ineffective tax administration stimulated by over-reliance on crude oil exports which gave rise to inattention to other tax revenues. Slightly, over 10 million Nigeria tax-payers were counted under the personal tax with the Federation Capital Territory included. It is not surprising that about 4.6 million of these tax-payers were under the city of Lagos State Inland Revenue Services alone as the city is large in terms of the number of tax payers. An average of 1.50% were under the domain of each of the remaining 35 counties of the Nigerian Federation (Oyelade 2016). As at the end of the year 2015, Nigeria had a workforce of around 78 million. According to their National Statistical office, only around 10 million (approximately 13%) of the total working population were in the tax mesh. This somewhat mirrors the case of corporate taxpayers.

According to Olokooba, Awodun, Akintoye & Adebowale, (2018), the former finance minister of Nigeria stated that the rate of compliance was around 12%. This is a very low tax compliance rate. Before the upward revision in the corporate tax rate implemented by present Nigerian Government, the recent former minister of finance of Nigeria stated that more than 75% of the enumerated entities in Nigeria "are beyond the income tax web; what is even worse is that approximately 65% of those noted to be in the tax net scarcely file any tax returns, neither do they pay any taxes at all". The inference of all this is that lesser than 10 percent of entities operational in the state of Nigeria are compliant with the tax responsibility" Olokooba et al. (2018) asserted:

> The continuous breach of tax regulations and the ongoing increase in inadequate tax adherence have compelled Government authorities at various levels to re-evaluate their approaches to prosecution. With the goal of enhancing tax collection. Tax evasion has been a persistent issue in the Nigerian tax system for a considerable duration, likely due to it being a significant challenge in achieving effective tax management in Nigeria. To address the challenges associated with inefficient tax administration, certain governments, such as Lagos State and a few others, have already implement specific

> measures. These measures include conducting tax audits, imposing tax penalties, and partially embracing tax amnesty when it was first introduced. (p. 47)

According to Wang and Hsieh (2015), a tax audit is all about examining and studying of the tax payers' fiscal records by designated Revenue officials, to check if the tax returns are a reflection of the actual taxes remitted by the tax payer. Likewise, a tax-penalty may be defined as a penalty given out because of non-compliance with relevant tax laws.

Tax amnesty is a tax window which allows voluntary and deliberate declarations of tax as well as payment of any such unsettled tax without the fear of penalties. According to Wang et al (2015), both advanced and emerging nations have embraced the agendas of amnesty as better expounded below:

> Practically, every state in the United States has implemented amnesty programs. Likewise, the Spanish Government introduced a tax amnesty in 2012, targeting undisclosed assets and assets held in tax havens. It allowed for the repatriation of these assets, with a 10% tax requirement, as a measure to curb the outflow of funds from the country. In a similar vein, in 2017, The Nigerian Government launched the VAIDS (Voluntary Assets and Income Declaration Scheme) as a temporary and lenient tax amnesty initiative aimed at encouraging defaulters to comply with tax regulations. The scheme aimed to promote greater tax adherence, the settlement of outstanding tax debts, and the prevention of tax evasion. (p. 77)

Several studies have taken place to examine as well as to ascertain the impact of income tax audits and the related consequences on the basis of tax amnesties. Revenues from tax increased except that tax audits and penalties are ineffective (Alm, Mckee and Beck 1990). Muhrtala et al (2013) believes that "tax amnesty may increase tax compliance provided that stringent procedures are embraced like continuous tax audit with related trials" (p. 33). Likewise, the likelihood of frequent audits can result into increased levels of income tax compliance providing that a bigger tax consequence is assumed, which had the ability of deterring tax non-compliance. This will in turn increase the number of partakers in the tax amnesty program as well as increase participation in the tax amnesty program (Puri et al 2018).

According to Ibrahim et al (2016) and Onuoha et al (2016), several administrative procedures are obtainable when deliberate tax compliance appears problematic. These encompass activities such as tax audits, the imposition of tax penalties, the provision of tax amnesty, the levying of fines for tax non-compliance, the seizure of assets followed by their sale in cases of tax defaults, and the mandatory requirement of a tax clearance certificate for significant transactions, occasionally coupled with tax relief periods (Anah et al 2018 & Samuel 2015). Hence current literature suggests that a connection exists between the above-mentioned tax prosecution tools with related tax submission. The following sub-sections briefly discusses the current literature on general tax prosecution tools.

#### 2.4.1.1 Tax Prosecution

It can be stated that prosecution in tax administration serves a critical role in increasing compliance. The main aim of tax prosecution is "to safeguard firm observance to several compliance measures alternating from timely filing, accurate filing, to payment of tax liability as and when they fall due" (Ibrahim, 2016, p. 22). Principally, tax prosecution "isn't meant for dodgers only who flop in taking care of their tax duties, but also to good and regular tax filers just to inspire unceasing compliance" (Ibrahim, 2016, p. 22).

In recent days, general compliance tools can take many forms, including "of levies, search and seizures of defaulting taxpayers, fines, penalties, seeking and obtaining information from third parties like banks and court actions; It can also take a form of providing better taxpayer education and increased advertising of incentives in instances of being compliant, as well as tax prosecution" (Ibrahim, 2016, p. 36).

Tax prosecution generally relates to the act of making certain taxpayers are in compliance with relevant income tax rules or laws. Prosecution with the tax management is basically divided into two: implementation of tax laws and prosecution of judgment. The tax prosecution referred to here relates to the implementation of all those relevant laws that will assist the tax authorities in carrying out their duties, as opposed to the law relating to the tax applicable to the administration of relevant income tax laws. According to Macharia (2014) prosecution of a "verdict of a tax matter is characterized by an already decided court case taken against a tax defaulter". In West Africa in general, and Nigeria in particular, tax systems and tax administration might not be well-organized in the absence of tax prosecution. This is due to shrewd tax practices by a bigger proportion of taxpayers.

Marziana et al (2010) argues that tax compliance "is the level or the rate at which a taxpayer complies or defaults on the tax rules of their country" (p. 2). An important aim of any tax Management is to attain higher tax compliance. Compliance with related tax reporting rule implies that the tax-payer submits all needed income tax returns in a timely manner as well as "that the tax returns properly report tax liabilities in line with the tax rules, and perhaps court judgments, if any, which are appropriate when the tax return is being filed" (Roth 1989 p. 5). This explains the basic difference between compliance and non-compliance with tax.

Whether the taxpayer "intentionally or unintentionally fails to disclose proper tax liability will have the same non-tax compliance outcome, meaning, the outcome will be the same whether the mistake is honest or not. According to theory above, evasion of tax is taken as the willful action of non-conformity to applicable laws with the intention of decreasing the liability".

#### 2.4.1.2 Tax Audits and related Compliance

A key element which governs tax compliance levels and which is significant in compliance literature are the tax audits. According to Anah (2018), a tax audit is defined as an independent review of a tax payers financial records, tax filings, tax payments, and related documentation to ensure alignment with legal tax obligations, rules, and regulations, as well as the accuracy and adherence to generally accepted accounting principles. A tax audit is a process in which tax authorities examine the tax documentation of an individual or entity to verify their conformity with the state's applicable tax laws and regulations.

The importance of tax appraisals is dependent on the following two factors: the total number of tax-payers selected for auditing and the concentration and meticulousness of the audits. The quantum of tax audits is taken as the quantity of tax-payers divided by the number of tax audits done. According to Adeniran, et al (2013) and Ladi, et al (2015), a tax audit is about the amount of tax for practical comparison and analysis. A rise in the number of audits is said to decrease the quantity of "other administrative activities, such as taxpayer service, collection of taxes" (Ibrehim 2016, p.12). As Mahfa (1994) and Oyedekun (2015) observed, tax audits are an important compliance tool due to very high tax non-compliance observed in the under-developed nations. Tax audits are done in order to force evading entities and individuals to return to compliance. Tax non-compliance is demonstrated by failing to remit the essential tax, failure to file appropriate tax returns, misrepresenting of income, over-statement of claimable expenses or failure to remit the correct taxes (Mahfar, 1994; Ojonta, 2011; Oyedokun, 2015;). Therefore, it can be concluded that a tax audit is an important instrument for compliance with tax laws.

As per study by Oladele, et al (2019) prosecution has shown that a marginal increase in tax audit and tax penalty would lead to an increase in tax compliance. This suggests that tax audits and the imposition of tax penalties should be encouraged and sustained as they are envisaged to further improve the degree of tax compliance, and consequently enhance government tax revenue generation. However, the same study found no significant association between tax amnesty and tax compliance. On the basis of this finding, Oladele, et al (2019) argue that tax amnesty is probably just a new policy that was introduced to encourage voluntary tax compliance.

#### 2.4.1.2 Tax Fines, penalties and Tax compliance

The penalty rate is typically applied by the Revenue establishments “to decide the tax fine to be paid by the evading taxpayer” (Ladi et al. 2015, p 12). The extent of the tax punishment payable is dependent on the type and amount of tax evaded. For instance, late filing of the tax returns, normal filing but with wrong returns, refusing to maintain appropriate records from source documentation like suppliers’ invoices and customers receipts attract different tax penalty rates (Chikosi 2015). Through deliberate unlawful tax evasion, the tax punishment is higher than that of deliberate evasion.

There has been established a formal relationship regarding fines and compliance of tax. Hyun (2005) established that a relationship exists between fines and tax compliance. A study by Park et al. (2005) established that tax compliance is boosted with fines than is done with the likelihood of an audit. According to Friedland et al (1978), holding constant the anticipated tax but altering audit probabilities with fines for non-compliance, compliance moves up appropriately with risen fines, but not with higher audit probabilities. However, a study done by Brautigam and Mick’s

(2008) argues that there is no relationship between fines and related tax compliance, but audit probabilities and tax compliance. This suggests that in a hostile environment, fines may be perceived as hostile and unacceptable. In a friendly climate, however, fines may be observed as a tolerable vengeance for behavior which injures the public.

A study by Alkhatib et al (2018) relating to the "impact of tax deterrence factors on income tax evasion among Palestinian SMEs" employed "a model of the research founded on the tax economic Deterrence Theory. As observed earlier on, this theory connotes that conduct of taxpayer respondents is predisposed by the likelihood of tax fines, detection and rates of tax relating to the theory of Deterrence, the changes in crime inclination amongst persons depends on the anticipated cost or benefit as opposed to the variance in the incentive to obligate crime. It can be said that the implication of this theory means that a taxpayer is balanced in his resolution and simply purposes at getting the best out of the anticipated utility. The unit of observation for the Palestinian study was at the corporate. The research data was taken from 400 SMEs enumerated in the Association of the Palestinian Chamber of Commerce. An impartial random sampling technique was employed to allocate the questionnaire amongst selected respondents who were mostly managers/owners of SME enterprises. The questionnaires were disseminated over a period of two months. A total of 180 useable questionnaires were obtained, after selection, which represented a 45% rate of response. The variables together with the items employed in this research were adopted from earlier studies. In order to quantity the issues in the current study, a five-point likert scale" was used to quantity the issues in this study starting from "strongly agree (1)" to "strongly disagree (5)" relating to all variables. The "fifteen matters for evaluating evasion of tax were all adopted from Giligan et al (2005). Reverse coding was employed for items in this study, so as to escalate the internal validity" (Efeber *et al*, 2004). The likelihood of discovery was measured by 3 items as modified after Efeber et al (2004). The measurement model was appraised by means of the two methods of legitimacy: "the convergent and discriminant validity. The convergent validity was assessed by analyzing the indicators loadings, average variance extracted (AVE) and composite reliability. The predictive strength of the research model was estimated using R-square (R2) (coefficient of determination)). The Smart PLS algorithm function was employed to measure the R2 value, which is the amount of variance accounted for by the exogenous variables (Hair *et al*., 2017). The three variables had an R2 value of 0.184 implying that 18.4% of the variation in the income tax evasion is accounted for by probability of detection, tax penalty and tax rate. The study observed that an existence of effective deterrence can encourage taxpayer's compliance, especially if the risk of detection of evasion is higher than paying taxes. Hence, it was suggested that the tax authority should widen their sample of audited taxpayers alongside imposing tough tax penalties as a valuable policy aimed at discouraging tax evasion. Furthermore, taxpayers perceived the current tax rate as unfair, hence demanding a preference for a progressive tax rate structure. The findings of the study offered a better comprehension of the determinants of income tax evasion. Particularly in strategic planning associated with tax structure, confronted with the challenge" of what Hair *et al.*, 2017 called declining income tax revenue.

A study in Nigeria by Anyaduba et al (2014) with a title of "Impact of Deterrent Tax Policies on Tax Compliance: The Nigerian Experience" did a study regarding the "influence of deterrent tax measures on compliance in Nigeria". This study "engaged the quota method of sampling. Data used in this study was mostly primary sourced. Questionnaires amounting to 200 were given out, and only one hundred and sixty of them were given back and employed in this study. Hence, there was a 75% rate of response. The inquiry forms were distributed to a cross section of Nigerian taxpayers in the private and public sectors". The "private entities institutions of interest included finance, engineering and building trades. Entities in the Government sector taken for the current study comprised of the Administrative Departments, Ministries and departments in the state Nigeria. Questionnaires were directed to personnel of these institutions to obtain answers relating to the insights of deterrent tax dealings". The questions were organized on a five-point Likert scale alternating from "Strongly Agree" to "Strongly Disagree. The method of data analysis used in the study is the ordinary least square regression method. The technique was embraced as a result of its characteristic of dependability, unbiasedness and competence. The regression method was projected by means of a computerized software called Micro fit. The coefficient of determination (R2) with a value of 0.64 showed that approximately 63% of the entire logical variations of the dependent variable, are expounded by descriptive variable taken all together. The adjusted R squared showed that after modifying the extent of autonomy, model used was able to explain only 58% of overall logical variations in Tax Computation, when around 44% of the logical variant in Tax Computation was not accounted for", which, According to Anyaduba et al (2014), "was not taken by stochastic disturbance term in the model. This indicated a good fit of the regression line and also the model has a high forecasting power. On the basis of the overall statistical significance of the model as indicated by the F-statistic, it was observed that the overall model was statistically significant since the calculated F- value of 7.28 was greater than the critical F- value of 2.2 at 5% level of significance. This shows that there exists a linear relationship between the dependent variable (Tax Computation) and all the explanatory variables taken together.

The results of the analysis revealed that the existing deterrence tax policies in Nigeria are inadequate and have not helped to promote tax compliance. These findings appear to be consistent with OECD (2004) prescription on ways developing countries can increase their revenue base through taxation. According to OECD (2004), developing countries can boost their tax revenues.

#### 2.4.1.3 Deliberate Tax Compliance window/tax amnesty

Tax amnesty "is the action of decreasing or disregarding totally a certain or an unspecified penalty by the governing bodies through their Revenue authorities" (Osman & Eren 2011 p. 32). Amnesty generally means to surrender the right. It is characterized by the legal deals that eliminate the likelihood of some punishment by means of a tax penalty, and to halt, either partly or wholly, the application of some form of penalty by means of a fine or any other type of penalty arising from tax non-compliance. According to Ojochogwu (2012), amnesty eliminates the fines and sentences to be effected on tax dodgers.

Amnesties are employed many times by several developing and industrialized nations and the result was as desired (Wang 2015). According to Osman et al (2011), an amnesty platform differs from nation to nation and also differs in coverage. It can however be commented that the tax amnesty program has not in all cases yielded desired result since while huge revenues were made in certain nations, the program failed miserably in other nations (Torger, 2003).

The Malawi Revenue Authority (MRA) effected a deliberate tax Compliance Opening called "Voluntary Compliance Window" (VCW) in 2013, for the tax year 2013/2014 as a way of bringing into the tax net noncompliant taxpayers (Masiya 2019). This opening lasted for three months, starting on 1st November 2013 to 31 January 2014. Over these three months, the taxpayers were obligated to voluntarily come forward and declare their tax liabilities and in so doing, would only pay the principal amount and not the associated penalties" (Masiya 2019). The other aim of this agenda was to rope into the tax net the taxpayers who had never paid tax subsequent to the commencement of their trades. According to Masiya (2019), the window was considered a big success in relation to revenue and price of tax collected as demonstrated by the following statement:

> This program generated the sum of MK4.25 billion, which was approximately 1.1% of gross tax revenues for FY2013/14, from 950 taxpayers. Of this total of MK4.25 billion, MK122.80 million was from new taxpayers and MK4.13 billion was from the payment of existing taxpayers who committed tax offences before the program was announced (henceforth, succinctly referred to as amending taxpayers). The tax that was paid by the most taxpayers (437) was the corporate tax which accounted for 47.1 percent of all of the taxpayers who participated in this program. This was seconded by Pay As You Earn (PAYE) (31.8%) and Value Added Tax (VAT) (23.3%) taxpayers. (p. 22)

A study in Nigeria by Anyaduba (2014) with a title of "Impact of Deterrent Tax Policies on Tax Compliance: The Nigerian Experience" studied "the impact of deterrent tax measures on compliance in the state of Nigeria" (p. 1). The results noted that adopting deliberate submission and augmenting taxpayer's confidence enhanced tax compliance in the state and lastly that consolidation and implementing taxpayer's confidence enhanced compliance. It can therefore be said that the state of Nigeria together with the rest of the developing countries should search the prevailing research and applied knowledge from both advanced and less developed states in order to devise a strategy which works and which can help to augment the nation's taxpayer's compliance. The study recommended for the Nigerian Revenue Authority to strive as much as possible to assume the method which would inspire compliance voluntarily as well as recommend suitable sanctions to nonpayers. The study also recommended for the OECD risk-based treatment strategy to be embraced. The OECD strategy offers a progressive reaction to tax compliance deeds in order to ease those that would like to be compliant to do so without problems and enforce those not complying. Finally, the Government is recommended to make sure that taxpayers comprehend the tax responsibilities with ease of compliance. This will require that the government together with the Revenue Authorities must act with honesty and in such a way as to be perceived just and equitable dissent.

## 2.5 Current literature on social psychology deterrence theory

### 2.5.1 Introduction

According to the "ground breaking" study "social and psychological features came into the limelight of research in compliance of tax in the late 1950's, which announced fiscal psychology as a separate division of public accountability" (Onu and Oats 2016). Onu et al (2016) suggested as a theme of learning "individuals tax mentality, which is in turn is dependent on the broader tax mentality of their nation, profession, or social class, a concept similar to social models" (Onu et al 2016, p. 4).

The 1980s witnessed expansion of a number of "psychological tax compliance simulations", a number of which brought concepts comparable to "social norms as elements of taxation compliance. Slightly recent, attention to the social and psychology concept of social models arose from cross-cultural study findings in the culture of taxpayers across the nations, variances which are believed to be attributable in part to social models concerning tax ducking" (Torgler, 2006; Cummings and McKee, 2001, p 4). According to (Kirchler, 2007), "although fiscal psychology approaches have made important contributions to understanding the drivers of compliance, they have been far from dominant in the field of tax compliance research. The dominant stream of research in the last decades has placed greater emphasis on deterrence factors like fines and audit probability, than on social factors as determinants of compliance (Kirchler, 2007), a stream of research, according to Gemmell (2016), originated in the classic model of tax compliance of Allingham and Sandmo (1972). Though Allingham and others located specific importance on financial deterrence features, they included status consequences, "the consequences of committing evasion on one's reputation as a member of the community, as a normative factor involved in tax evasion decisions" (Gemmell 2016, p. 12).

The study by Doerrenberg and Peichl (2018) agreed that "it is now generally acknowledged that the choice for tax avoidance is motivated by several factors other than the extrinsic, economic influences like tax rates, penalties, audit probabilities and tax enforcement as observed under the general economic deterrence above" (p. 7). General economic deterrence alone has been unable to explain the levels of tax obedience in reality seen in several countries, especially in the west (Graetz et al, 1985; Alm et al., 1992; Frey et al 2002). Research has been faced with a main puzzle: in the developed world where economies are at advanced stage, tax compliance level is by far greater than that projected by economic deterrence concepts (Graetz et al, 1985 and Alm 1992). Just as Andreoni et al (1998) observed, the developed world is showing a much higher tax compliance which can't be explained by the economic deterrence tools only, like tax audits and higher fines:

> The level of detection probabilities and fines are too low to explain the (rather low) levels of tax evasion observed in developed economies. This has given rise to a growing literature analyzing the importance of behavioral and cultural aspects in explaining taxpayer behavior. (p. 22)

According to Luttmer and Singhal (2014), inherent and non-monetary aspects become important too when it comes to income tax compliance. These alternative remarks have many times been mutually labeled by means of the wide tag of tax morale (Luttmer 2014). The concept embraces ethical rules and feelings of people which at the end compel them to pay in full their tax liabilities, societal standards which styles tax evasion and dishonesty on tax an unwelcome activity while the rest of the people are being compliant, "and a sort of reciprocity response of the individual in its relation to the State in the sense that citizens will be more likely to comply with their tax obligation when they see that the government performs well in terms of delivering public goods and services" (Doerrenberg and Peichl 2018). Tax morale is an "umbrella term for such intrinsic tax-compliance motives; and whereas tax morale is molded by several influences such as guilt, preferences for honesty, moral sentiments and cultural factors, societal norms and mutual benefit (reciprocity) are oftentimes taken to be determinants too" (Luttmer and Singhal 2014). According to David et al (2020), tax morale is a general term which is concerned with "the intrinsic motivation to pay taxes or feel guilt from failure to comply. It is linked to domestic tax evasion by underreporting taxable income.

In this study, reciprocity is taken to imply making the required tax payments but also at the very same time expecting to receive a certain amount of quality service from the Government to which the tax has been paid. Luttmer and Singhal (2014) identifies that the main motivating factor behind compliance may depend on the perceived quality of government services which citizens receive in return for their tax payments.

The determinants of tax morale have been widely explored internationally, for example, DeBacker, Heim, & Tran, 2015; OECD, 2013; Luttmer & Singhal, 2014) noted that tax morale was negatively correlated with shadow economy activities and positively correlated with direct democracy. This may be explained by differences in the fairness of tax administration, perceived equity of fiscal exchange, attitude toward respective governments, differences in culture, which also interact with demographics (Botelho, Harrison, Hirsch, & Elisabet, 2018), and trustworthiness (Ashraf, Bohnet, & Piankov, 2016). However, proxies for tax morale are challenging the concept. Slemrod and Weber (2012) argued that a single tax morale indicator, rather than an index of indicators, provides a more straightforward measure of its relative importance. Recent survey efforts on culture and social values include questions on attitudes toward tax paying and corruption, amongst others (World Values Survey). Herein, we use an indicator based on country-level survey response data to questions of perceived tax fairness. This can be linked to the notion of provisional collaboration.

Doerrenberg and Peichl (2018) observes, “social norms of tax-compliance behavior particularly depend on the perception about the prevalence of tax evasion in society” (p. 7). The greater probability is that tax payers will be motivated to evade tax payments when they are of the conviction that other tax payers evade taxes, when they are of the conviction that tax non-compliance is prevalent and may be more tax compliant when they are of the conviction that many of their fellow taxpayers remit the taxes with all honesty.

### 2.5.2 Some recent literature on social psychology deterrence theory

A random study research by Doerrenberg and others (2018) regarding the area of “tax Morale and the Role of Social Norms and Reciprocity: Evidence from a Randomized Survey study” established that contributors “in a social-norm treatment” exhibited “lower tax morale in relation to a control group while participants in a reciprocity treatment have significantly higher tax morale than those in the social-norm group” (p. 2). A possible rebound impact of social standards is overshadowed “if the costs of violating the social norm are made salient” (Doerrenberg & others 2018, p. 4)). The study had the “subsequent question assessing tax morale in the GIP. The question formulation was analogous to that employed in the World Values Survey (WVS) which Alm, Slemrod & Joel (2019) and Torgler (2006) all agree is extensively used in the tax-compliance literature, by creating a hypothetical condition in which taxpayers have an easy opportunity to evade" and it does not ask participants about their actual tax-compliance behavior. "It was found that first, manipulating the social norm through information about the general extent of tax evasion has a negative effect on tax morale, relative to the control group. This confirms that social norms can backfire if they reveal that a certain behavior is regrettably frequent. Second, if an appeal to reciprocity is added to the social-norm information, tax morale becomes significantly larger. The treatment reminds participants that beneficial government services can only be provided in return for compliance among taxpayers. The findings suggest that such an appeal to reciprocity works and that a backfire effect of social norms is outweighed if the consequences of the social norm are made salient" (Besley, Doerrenberg & others 2018)

Current literature in the area of tax morale finds social relation variables as a center of tax morale. Besley et al (2015), and Bénabou (2011) shows, for example, that the intrinsic motivation of taxpayers to fulfill their tax obligations is influenced by societal norms. It's important to note that comprehending tax compliance cannot be adequately explained solely through the economics-of-crime approach because it's a multifaceted matter. In other words, considering factors like penalty schedules and the likelihood of detection alone doesn't suffice in forecasting taxpayer behavior. While economic deterrence models suggest that individuals make decisions solely based on maximizing economic gain, social psychology models aim to elucidate and predict human behavior by delving into their underlying attitudes, norms, and beliefs.

These models focus on the notion that if we can understand an individual's behavior, it becomes possible to grasp and anticipate their attitudes toward tax compliance decisions. Broadly, there are three well-recognized social psychology models employed in tax compliance research: Compositional Modeling, Attribution Theory, and Equity Theory.

Social psychology prototypes that have as a basis the Attribution theory explains how persons gauge the grounds of distinct conduct or activities of other persons (McKerchar et al., 2013). In truth, many persons are not informed and create choices grounded on perception of the causes of events and actions happening around them (Kaplan 1988). Taking the "attribution theory as a basis, if evasion of tax is taken as an intolerable conduct culturally and the tax-payer is recognized as the tax evader, this would lead to a judgment of social irresponsibility and that individual would lose his\her social credibility (Arrington 1985). Hence, in line with the theory, evasion of tax would be taken as unethical conduct, if everybody committed it. As an example, in case a taxpayer failed to correctly report revenues and then is caught, this taxpayer may use situational factors" as a defense by stating that everybody is a defaulter.

### 2.5.3 Social influence (Trust in Government, national pride, importance of Government)

Social capital takes a pronounced consequence on tax morale. An investigation by Torgler (2003) regarding the relationship between "trust and tax morale" obtained data from 20 developing nations, covering the years 1990-1999. Confidence in a government as well as confidence in a legitimate structure were noted to be important and positively related. It is said that Spirituality and religion may prevent evasive behavior as they are said to have a sanctioning system in itself that legitimizes and supports social values" (Hirschi et al, 1969). Torgler (2006), also, "expounds on a notion of religiosity as a feature which impacts on tax morale". This was originated "on survey questions which measure attendance at church, religious teaching, church involvement, and significance of religious conviction, religious leadership associated with good and evil and trust in the church" (p. 22) as an entity. According to Torgler, 2006, all these "fundamentals are established to take a substantial positive effect on the morale of tax". Literature of Criminology has also conveyed an adverse relationship between religiosity and crime (Torgler & Schneider, 2007). For example, as religious beliefs decline the level of criminal activity, tax morale increases.

According to the equity theory, once remitting tax to the government is considered as a nationalistic and patriotic activity, objectivity may be exhibited in the loyalty of a taxpayer to her nation (Torgler, 2003). This type of state pride shows a person's behavior within establishments, clusters and humanity (Torgler & Valev, 2010).

It can therefore be stated that a rise in nation-wide pride would result in an increase in compliance of tax of a nation. The Government together with its citizens are in some form of relationship. This relationship is not just about the supply of public goods and services, but there is also a mental association which includes the manner in which both sides take each other as well as the impartiality of the actions which leads to a political outcome (Lago et al 2010). Tax evasion can as well be taken as a tool to penalize a monster government which is concerned with only increasing the tax collected without any regard to policies considered as fair by the taxpayers (Schnellenbach, 2006).

A study by Ali et al (2015) centered on “the attitude of Citizens towards tax” which was carried out in Uganda, Kenya, Tanzania and South Africa, a minority of variables were comprised in the analysis of regression to obtain the taxpayers’ contentment with provision of various services and goods which citizens required from the Government. This study included contentment with government’s delivery of community goods like Agriculture, internal security, educational and health services; structures, like government provision of sanitation and water amenities, infrastructures maintenance as well as bridges, and delivery of dependable electricity energy; management of criminal activities by the Government, internal conflict, internal and external terrorism and corrupt activities; level of contentment with how easy it is to obtain simple services from the Government like drivers permits, national identification cards, domestic services as well as police services. Selected sampled respondents were requested to rank their level of contentment with delivery of such services and goods stretching from 1= “very badly” to 4= “very well”. In some rare cases where “respondents stated that they neither know nor have they ever heard of these services, these were subsequently left out of the sample. The study formulated an index for a taxpayer’s contentment with the provision by the Government of such public goods and services” which ranged from “1 to 4”. Upper values meant persons were highly contented with delivery of different amenities by their respective Governments. The study used insights “of other people’s tax compliance as a proxy to measure the influence of other people’s behavior on tax compliance attitude. The variables were measured in form of a reply which took 1 as to mean that respondent thought other taxpayers never avoided taxes, and 5 to mean that they thought other taxpayers always avoided. Higher values denoted taxpayer’s opinion that the other taxpayers are not tax compliant.

Results of the Ali, Fjeldstad and Sjursen (2015) study in the East African countries of Tanzania and Uganda found that “participants that are happy in the way their country is providing health and learning services have a more compliant attitude of 6% and 9%, respectively” (p. 87). In Kenya, participants who are happy with the way the Government is providing roads and educational services have compliance outlook of 11%. In the Republic of South Africa, taxpayers that are happy in the way their country offers various services like dispensing of identity cards as well as receiving household and policing services had a tax compliant outlook of 17%. The above results which came from the 4 nations propose that national expenses can inspire tax obedience, suggesting that the nations can cultivate a tax compliant attitude by offering services which residents require in an effective and manageable manner (Tilly 1992; Moore 2004). The outcomes in these countries showed that each country required diverse goods to motivate its citizens to observe their tax regime.

Ali, Fjeldstad and Sjursen (2015) suggests that the degree to which persons believe “that their own ethnic group is treated unfairly is also significantly correlated with compliant attitude in South Africa and Tanzania” (p. 5). As the extent to which individuals think that their own ethnic group is treated unfairly increases by one point, the probability of having a tax compliant attitude decreases by 6% both in South Africa and Tanzania (Ali, Fjeldstad & Sjursen 2015, p. 5). It can be argued that this provides support for the comparative treatment model, which is based on equity theory and suggests that addressing inequities in the exchange relationship between government and taxpayers matters for tax compliance (Persson 2008; Rothstein and, 2008). Nevertheless, this association appeared not to be present in Uganda and Kenya because this study failed to create any substantial outcome. In Tanzania, a rise in the level of approval of the general presentation of political figures was found to surge the likelihood of taking a compliant outlook” by more than 3%.

A study from Ortega and Sanguinetti (2013) tracked the “tax compliance of local businesses amounting to over 6,000 companies of a key city of Caracas, which was haphazardly allocated to a control of no stimulus, or to one of five treatment arms that received letters from the local tax administrator with different types of messages regarding tax compliance. The study found that “implementing communication that escalates likelihood of discovery had the biggest effect of compliance, a communication relating to provision of the public services and goods given by their country and which affect businesses directly, has the next biggest impact while other messages have greatly lesser effects to compliance” (Ortega & Sanguinetti 2013). Over and above, it was observed that the reciprocity communication appeared to have more permanent impact in comparison to the enforcement communication.

Generally, the findings above appear to offer backing for both the reciprocity and deterrence hypotheses relating to compliance of tax, and, according to the findings of Ortega and Sanguinetti (2013), increased implementation and made:

> Better connection between taxes and quantity and quality of public service delivery could help to enhance tax collection”. The fact that both, the letter stressing redistributive programs and that one that simple states that paying taxes is the right thing to do imply much weaker effects in terms of actual tax compliance suggests that within all the possible

> tax morale arguments the ones that matters the most are those that stress a reciprocal behavior towards the State, which provides public gods and services. Secondly, the fact that the placebo letter has also a significant but very small impact suggest the result we obtained are not driven by the simple fact that the taxpayers feels that the tax agency has somehow identified him (so he may be subject to audits or controls in the future), and that the content of the letters does matter (p. 87)

A study conducted by Battiston in 2016, titled "Impact of Social Pressure on Tax Compliance: A Field Experiment FBK-IRVAPP Working Paper No. 2016-04," examined the relationship between social pressure and tax compliance among shop sellers. The research focused on the practice of requesting formal receipts from bakery item sellers who did not routinely issue them. This practice was a significant aspect of the study.

The study manipulated the sellers' perceptions regarding the Italian community's stance on tax avoidance. The results indicated that tax compliance cannot be solely attributed to tax enforcement measures; instead, it is influenced by behavioral factors that affect the buyer-seller relationship. Specifically, the research revealed that direct societal pressure increased the likelihood of sellers providing receipts by approximately 17%, and this result was statistically significant at the 10% level. Furthermore, the findings suggested the presence of a societal financial multiplier: when one buyer requested a receipt, the seller ended up issuing about 2.5 more receipts, contributing to increased tax revenue by confirming sales and associated tax payments.

The study also identified a noticeable decrease in the likelihood of receiving a receipt when the buyer and seller were of the same gender. This observation was particularly interesting as the gender of the buyer was not influenced by any characteristics of the bakery, implying a deeper connection between gender concurrence and tax compliance. The impact of this gender-related variable was more significant than the influence of the buyer's or seller's individual gender, which was not found to be significant. This result suggests that tax evasion is more likely to occur when individuals collude, and collusion is less common when individuals come from diverse social backgrounds, as defined by gender, thereby reinforcing Torgler's perspective.

Battiston's study also noted that in developing countries, building trust as part of tax reform strategies is crucial. Trust in tax authorities is often limited, compliance is poor, and political support for taxation is lacking. The research across 36 countries indicated that Africans had more trust in informal institutions like religious and traditional leaders (72% and 61%, respectively) than in tax departments (average of 44%). Additionally, a significant portion of Africans believed that people working for domestic tax agencies were corrupt. Unfairness and inequity in tax burdens were prevalent, with weak enforcement among elites coexisting with heavy tax burdens on lower-income taxpayers.

Several existing studies suggest that even small measures to enhance trust can lead to significant improvements in tax compliance and reduce political resistance to reform. Focusing on building trust can help break the deadlock in tax collection, as taxpayers may be more willing to pay taxes in exchange for improved government services. However, governments are often hesitant to increase enforcement due to short-term political costs and a lack of trust that taxpayers will reward them even if new revenues translate into better services. A strategic focus on building trust can make tax reform more popular and generate political benefits in both the short and long term.

To put the growing interest in building trust into practice, there is a need for clearer definitions, concepts, and strategies. While tax morale is often linked to ethics and values, recent research suggests that cross-country differences in tax compliance are primarily driven by variations in governance rather than individual ethics and values. Strengthening trust in tax systems should be operationally focused, with a focus on whether governments meet normative expectations and whether they will continue to do so. Trust is a learned behavior that can change over time in response to government actions, policies, and implementation. Concrete government actions can increase trust, compliance, and support for tax reform. Social norms play a vital role in translating increased trust into compliance, and they can evolve over time.

Ultimately, trust around tax compliance should be constructed through reciprocal action by both taxpayers and governments. Blind trust in government is not the goal; instead, trustworthiness must be developed through fairness, equity, reciprocity, and accountability. Taxpayers will trust the government more when it demonstrates these qualities, and governments will trust taxpayers more when they observe increased tax compliance in response to improved government performance and transparency. Given the limited public trust in public authorities, improvements are likely to be gradual. The payoff for governments is evident: improved tax compliance and the construction of political support for ongoing reform and enhanced enforcement.

In summary a study by Ali, Fjeldstad and Sjursen (2015) found “that the perceived requirement to pay value added tax and the respondent’s satisfaction with the government’s service provision have the largest predictive effects on tax compliance” (p. 22). Just like the results of “logit regression analysis in Uganda and Tanzania, persons who are happy with their governments treatment of educational and health needs are highly probable” to reply “wrong and punishable”, are unlikely to give a response “wrong but understandable” as well as “not wrong at all”. Just like results of logit regression, the persons who are happy with the manner in which their Administration handles substructures, like roads & energy, are highly probable to answer “wrong and punishable” and unlikely to answer “wrong and understandable” and “not wrong at all”. In Uganda, “satisfaction with the government’s handling of security is more likely to make individuals respond wrong and punishable and less likely to respond wrong but understandable” “not wrong at all” (Ali, Fjeldstad & Sjursen 2015). In South Africa, “contentment by means of the manner the administration provides simple amenities like supplying of national identity cards, domestic amenities and policing amenities” make persons most probable to reply “wrong and punishable” and unlikely to reply “wrong, but understandable” and “not wrong at all” (Ali, Fjeldstad & Sjursen 2015).

According to Enachescu et al (2019), **“**the slippery slope framework of tax compliance” emphasizes the importance of trust in authorities as a substantial determinant of tax compliance alongside traditional enforcement tools like audits and fines.

Using data from an experimental scenario study in 44 nations from five continents ($N = 14{,}509$), a study by Enachescu et al (2019) found that trust in authorities and power of authorities, as defined in the slippery slope framework, increase tax compliance intentions and mitigate intended tax evasion across societies that differ in economic, socio, demographic, political, and cultural backgrounds.

The study also showed that trust and power foster compliance through different channels: trusted authorities (those perceived as benevolent and enhancing the common good) register the highest voluntary compliance, while powerful authorities (those perceived as effectively controlling evasion) register the highest enforced compliance. In contrast to some previous studies, the results suggest that trust and power are not fully complementary, as indicated by a negative interaction effect. Despite some between-country variations, trust and power are identified as important determinants of tax compliance across all nations. Findings like these ones have strong insinuations for “authorities across the globe that need to choose best practices for tax collection” (Enachescu et al. 2019, p. 3).

### 2.5.4 Political legitimacy

Social capital is said to have an impact on tax morale.

Investigation by Torgler (2003) explored the association concerning “trust and tax morale” collected information from twenty developing nations covering the period 1995-1999. As Hirschi et al (1969) puts it, “trust in government and trust in legal system are found to be significant and positive” (p. 12).

Religious practices can serve as a deterrent to unlawful behavior due to their inherent system of sanctions, which legitimizes and upholds societal values. Torgler (2006) further delves into the impact of religiosity on tax morale, using survey questions to gauge factors like church attendance, religious education, participation in religious activities, the significance of religion, and trust in the church as an institution. It's noteworthy that all these variables demonstrate a substantial and positive influence on tax morale, as outlined by Torgler (2006).

Criminology literature has also documented a negative association between religious affiliation and criminal activities (Torgler & Schneider, 2007). Consequently, a decline in religiosity not only reduces criminal behaviors but also has the potential to enhance tax morale.

According to the equity theory, when taxpayers perceive their tax payments as a patriotic duty, they link fairness with their loyalty to the nation (Torgler, 2003). This sense of national pride reflects an individual's conduct within various organizations, groups, and society at large (Torgler & Valev, 2010). An increase in national pride can lead to heightened tax compliance within a country. Moreover, the importance of politics as a variable also affects tax morale, and this connection aligns well with equity theories. The relationship between taxpayers and the government encompasses not only the provision of public goods but also a psychological dynamic that considers how both parties treat each other and the fairness of the procedures that lead to political outcomes (Lago et al., 2010).

Per Schnellenbach (2006), evasion of tax may be taken as a tool to penalize Monster government which are raise to tax income as opposed to taking the favorite procedures of a taxpayers.

The study measured “trust in the tax administration as way of a replying to the degree of belief which persons have in their organization” (Schnellenbach 2006, p. 14). Variables ranged from one equal “no trust at all” to five equals “trust a lot”. Likewise, “discernment of corrupt activities was taken by a person’s reply on number of officers they believe are tangled in corrupt acts”. The variables ranged from 1 equal “none” to 5 equals “all of them” (Schnellenbach 2006, p. 14). General contentment with the politicians was recorded as a reply of taxpayer’s view of “whether they approve or disapprove of the way the president/prime minister, member of parliaments and elected local officials performed their job in the past 12 months”. Replies ranged from one equal “strongly disapprove” to four equals “strongly approve”. Grounded on the replies from the above, “factor analysis” was used so as to devise a single pointer for a taxpayer’s level of contentment” with politicians.

### 2.5.5 Tax knowledge

In line with the attribution philosophy, a greater level of education can proliferate the level of taxpayer facts concerning the system of tax. As per Ross and McGee (2018), a learned tax payer should articulate tax issues as well as other fiscal issues with relative ease, in comparison to another tax payer who is not educated. Ross and McGee (2018) also believe that such an educated person should also be aware of the nature of support of régime services to its people. Such educated taxpayers are important in respect of how the collected tax is being spread to society (Ross and McGee, 2018). Over and above, highly educated persons are in a position to have more sophisticated ways tax evasion as well as tax avoidance (Torgler and Schneider, 2007). Hence, an advanced tax educational level appears to remain one of the best keys to tax morale increasing feature (Torgler 2006; Lago-Penas 2010).
Marital status may impact illegitimate and legitimate behavior, dependent on the degree to which persons are forced by their community linkages to behave in a certain manner (Tittle, 1980). For example, people who are married, in contrast with those who are not, are more tax obedient; this is because they are significantly constrained by their societal networks. It may be stated that taxpayers who are married have a higher morale of tax than those not married (Torgler, 2006).

Ali, Fjeldstad & Sjursen (2015) acknowledge that “tax awareness of taxpayers relating to the nature and amount of various taxes to remit to tax establishments has an effect on obedience attitude. Knowledge of tax was therefore measured as an answer of the degree of effort to have a proper understanding relating to the nature of tax to remit to the tax authorities”. Responses ranged from one = “very easy” to four = “very difficult”. Besides, a mock variable for the need to pay VAT was included. This variable was created from replies to this enquiry: “Regardless of whether you are able to pay, are you required to pay value added tax on the foods and the goods that you buy from shops or traders?” The variable had “one to mean respondents that stated that they remained obligated to remit the said tax and zero to mean that they are not obligated to pay. This type of question captures a key feature of the tax knowledge level of respondents because Value Added Tax is common and pervasive and all the respondents must come across it on a frequent basis in this country”.
A study by Ali, Fjeldstad & Sjursen (2015) found that knowledge of tax is largely associated with tax compliant attitude in South Africa and Tanzania. An increase in the perceived difficulty of finding out what type of taxes to pay by one point reduced the probability of tax compliance attitude by 8% and 5% in South Africa and Tanzania, respectively. This is equivalent to reducing the current share of people with tax compliant attitude, which is 57% in South Africa and 54% in Tanzania, to close to 51% in both countries due to a lack of appropriate tax knowledge. In the nations mentioned above, mock variable on apparent necessity to remit VAT showed a big as well as statistically important outcome on the likelihood of taxation obedience.

### 2.5.6 Demographic factors

Demographic factors, According to Toggle (2006), “have a significant effect on the tax morale”. The “number one variable is age of a taxpayer. In general, youthful taxpayers fear less about possible tax audits and any possible penalties (Sistema, Thomas, & Ferrier, 2003). Hence, increasing age of taxpayers appears to have an affirmative impact on the morale of tax (Torgler 2006). Subsequent to analyzing gender variable, Societal researchers suggest that females comply more, besides, are lesser self-contained than males” (Tittle, 1980). Conventionally, women are known with “conforming roles, moral restraints and more conservative life patterns” (Jackson & Milliron, 2016).

### 2.5.7 Economic Status Variables (Financial satisfaction, income)

Some researchers believe that those earning more income will be less compliant in terms of tax (Torgler, 2003). The argument is that the taxpayers who remit more tax basing on revenue do not automatically obtain greater yield in respect of administrative facilities (Jackson et al 2016). Hence it can be argued that this alleged perceived injustice will lead to lower tax morality. On the other hand, taxpayers that believe that they obtain more benefits from the government will have an enhanced indulgent of the importance of remitting tax (Duch et al 2000). Lower-income individuals may be less inclined to engage in tax evasion due to the potentially greater marginal utility or wealth reduction if they face penalties, as observed by Jackson et al. in 1986. However, Alm (2006) noted that, in alignment with the rational choice theory of crime, lower-income individuals might be more prone to participating in criminal activities due to their lower opportunity costs. Consequently, we cannot predict the direction of the coefficient on the income variable a priori.

The impact of financial satisfaction on tax morale can be explored from an equity theory perspective. Financial satisfaction hinges on a taxpayer's current income situation in comparison to others. The argument posits that taxpayers who are least satisfied financially may be more inclined to evade taxes in pursuit of an improved financial standing. Consequently, those who are the least financially satisfied are likely to exhibit weaker tax morale. According to Torgler (2003), financial satisfaction is expected to have a positive influence on tax morale, while "financial dissatisfaction may lead to feelings of unfairness and distress, resulting in decreased tax compliance," as suggested by Ross and McGee in 2018.

### 2.5.8 Conditional Collaboration Variable

Conditional collaboration is considered as a significant element which has a pronounced influence on the area of tax morale. The point is that if tax evasion is understood to be “wide spread and the behavior of one taxpayer can affect that of the other then this results into a decline in tax morale” (Frey et al 2007, p. 23). Tax morale, on the other hand, “increases if a taxpayer is of the belief that other taxpayers pay their taxes faithfully. The nations where their taxpayers do not copy the compliance behavior of other taxpayers will experience greater compliance of tax”. The above outcomes are established “in other researches in which strong peer effects result in lower tax morality” (Bobek et al 2012, p. 12)

Tax compliance “as a result of perception and opinion of other people was found to be significant in the country of Tanzania. While the perception that the other taxpayers dodge tax rises by 1percentage point, personal tax obedience reduces by about 10% in the state of Tanzania” (Ali, Fjeldstad & Sjursen 2015). This agrees with the concept which states that taxpayers who think that their colleagues are compliant with tax are highly probable to comply with taxes.

### 2.5.9 Gender and tax compliance

According to D’Attoma et al (2017), in advanced nations, where “social, political and cultural gender equality” (p. 3) is better than in emerging nations, several studies exposed important differences regarding income tax compliance behavior between women and men. D’Attoma et al (2017) carried out a “cross country experiment in America, the United Kingdom, Italy and Sweden. Results of this study disclosed that women are considerably more income tax compliant than their respective men under all conditions and in all countries where the study was done. Yimam and Asmare (2020) observes that in emerging nations where females are greatly marginalized and victimized in all material aspects, studies intended to investigate the aim of the behavioral variance in tax mobilization are very few. Results of these studies showed that business entities held by a women-majority were more income tax compliant than the ones owned by male-majority”. The outcomes of the study also showed that the likelihood of being income tax compliant rises when the share ownership of female owned businesses increases.

D’Attoma et al (2017) made use of the logit model estimation and results disclosed that in comparison to male business ownership, the probability of being income tax compliant was greater for women owned businesses. The research results implied that business owned by females or where the majority are females had a higher probability of being income tax compliant than where men are the majority owners of businesses. The research result also showed evidence that the likelihood of being income tax compliant rises with the rising business share ownership of women. Yimam and Asmare (2020) study also showed that where female ownership is 100 percent, that 100 percent, on average, there was a higher chance of more than 24 percent of being income tax compliant than where such ownership was 100 percent in the hands of their male counterparts. This study, suggests that, polices, rules and regulations meant to improve tax administration system, introduction of new income tax implementation as well as audit audits should all take into account differences in behavior between female and male ownership. As

Yimam and Asmare (2020) puts it “it is also necessary to improve women business participation in the country for equity concerns” just as such participation will result in curtailing income tax evasion. Another study by Aladejebi (2018) titled “the level of tax compliance among owners of small and medium enterprises (SMEs) in Nigeria had as a total sample size for the research of 413, out of which a total of 100% responses were obtained through an online questionnaire. The quantitative method was used in analyzing the data collected. STATA was used to analyze the data. Findings showed that female SME owners are more tax compliant than male counterparts”. The study recommended special tax payer education amongst owners of SMEs. The study also found out that Tax amnesty increased the level of voluntary income tax compliance.

### 2.5.10 Level of education and tax compliance

A study by Gitaru (2020) whose aim was to “assess the effect of taxpayer education on tax compliance in Kenya, the case of SMEs in Nairobi CBD” established a clear relationship between education of taxpayers using media such as electronic, print and direct engagement of stake holders.

The study population involved SMEs in Nairobi Central Business District (CBD). Collection of data was by way of pretested questionnaires to the owners of SMEs businesses. Data collected was subsequently analyzed by way of both descriptive and inferential statistics. The “nominal and ordinal data was collected using questionnaires and later subjected to quantitative analysis using Statistical Software for Data Science (STATA). Data was presented in the form of frequency distribution tables & graphs. The study results showed that indeed electronic taxpayer education, print media tax payer education, and stakeholder engagement, influences tax compliance among SMEs in Nairobi’s CBD area. Correlation Matrix was done to determine the correlation between the independent variables. The results showed that stakeholder’s sensitization is positively related to the taxpayers’ education to correctly calculate income tax, with a correlation coefficient of 0.810”. As a recommendation, the study suggested need to encourage tax payer education in order to improve income tax compliance. In the words of Gitaru (2020), “for SMEs to improve their tax compliances, those involved in their tax matters need knowledge and skills to interpret the various tax laws and regulations”.

Tax compliance procedures should be simplified because in most cases they are found to be very complicated by SMEs, especially for those who do not keep proper books of account and sometimes do not understand the tax laws in order to reduce the compliance costs in terms of money and time. Gitaru (2020) also suggests reduced tax rates made specific for SME entities, together with increased income tax incentives and some specific tax exemptions.

A desk study by Newman et al (2018) with the aim of evaluating "the impact of tax knowledge on tax compliance among small and medium enterprises (SMEs) in a developing country interrogated literature so as to ascertain if SMEs in the developing country under study possessed tax knowledge and also to identify the possible elements that constitute tax knowledge among SMEs. Other factors that could be influencing noncompliance among SMEs were identified as well as methods which could be adopted by tax Authority to increase awareness and compliance SMEs. The study established that SMEs in this particular developing country do not comply with tax law. They possess only basic tax knowledge and lack a deeper understanding of tax issues. It also emerged that enhancing tax knowledge on its own without addressing the high tax rates and corruption will not positively impact on tax compliance behavior among SMEs". This study recommended a preliminary income tax course to be introduced in institutions of higher learning, may be as an optional topic "so that students are aware of their responsibilities as future taxpayers" (Newman et al 2018., p. 7)

Another study in Indonesia by Inasius (2019) examined "factors influencing the tax compliance of small-and medium-sized enterprises (SMEs) for income-tax reporting requirements in Indonesia". The study used multiple regressions and examined six income tax compliance aspects. Data collection was done using a questionnaire survey which was conducted in Jakarta on a sample size of 328 SME business owners. Inasius (2019) employed a "researcher–administered questionnaire survey method for data collection. The results revealed that referral groups, the probability of audit, tax knowledge, and the perception of equity and fairness have a significant impact on tax compliance. In particular, the referral group had the most significant influence on the noncompliance behavior of SME taxpayers". The findings had the potential of enabling tax policymakers to come up with appropriate prospective tax policies which focus on income tax compliance of SMEs.

## 2.6 Tax compliance and financial performance of SMEs in Malawi and beyond

### 2.6.1 Introduction

In smaller economies, like that of Malawi, smaller entities have at all times been taken to be a key component of economic progress and industrial development (Aryetey et al 2004; Oludele et al 2012; Miller et al 2018). These SME organizations have progressively been acknowledged in the developing nations as "organizations which contribute extensively to the establishment of careers, fiscal progression as well as extinction of poverty in developing nations (Oludele 2012, p. 33). According to the World Development Report of 2005, generations of sustainable jobs and opportunities for small and medium entities remain the main approaches towards graduation of citizens from the trap of poverty. It is recognized that smaller entities are typically entities which are private and generally experience problems when engaging with governmental departments in general and tax authorities to be specific, mostly, from the emerging economies (Miller et al 2018). Most problems with taxation administrators can be considered to arise from badly coined tax policies as well as the absence of certainty concerning prospective policy fluctuations". Nevertheless, "it would be rare indeed to not observe complaints about the complication and/or ambiguity of the tax laws as well as high tax rates" (Baurer, 2005, p. 120).

A heavy load to the "tax paying entities may be created if the tax structure is not properly crafted to the unique environment of the applicable nation, and this eventually affects the final taxpayer as a result of the shifting ability of tax" (Miller et al 2018, p. 42).

Studies by Mnewa and Maliti (2008) present that "several SMEs remain unlikely to achieve the desired growth trends and profitability levels due to unfavorable tax policies. It can therefore be argued that it is critical for any Government to consider carefully, aspects which may influence on efficiency, economy and effectiveness of the smaller organizations. This is because, According to Miller and Wongsaroj (2018), small and medium entities remain key to economic growth of all nations, both developing plus developed. According to UNIDO (2009), small and medium organizations represent over 90% of private businesses and they contribute to more than 50% of employment and GDP in most African countries" (p. 2).

In Ghana, smaller entities characterized by the "production landscape have been noted to provide about 85% of manufacturing employment" (Aryeetey et al 2004). SMEs also "contribute about 70% to Ghana's GDP and they account for over 90% of businesses in Ghana" (Aryeetey et al 2004). From the above statements, it can therefore be argued that SMEs wield a vital role in motivating progress, creating work and contributing to alleviation of poverty, considering their commercial weight

Notwithstanding the input which tax is capable of making to what Chipeta (2012) has termed the Gross Domestic Product (GDP) of the nation Malawi, much is needed to look at negative effect of taxation in relation to long term survival of smaller entities. This is because SMEs play an important place in moving financial progress in developed and developing nations as observed above. As highlighted by Oludele et al (2012) and Miller et al (2018), “SMEs collectively do not only generate more new jobs than large firms or macro-enterprises but also introduce innovative ideas, products, and business methods”. According to Baurer (2005), studies are not sufficiently developed in areas of exploring the undesirable effects of taxation payments on the long-term SME survival and performance in emerging nations”. This has made Tee1 et al (2016) to observe that the above state advances a “serious concern about the issue of aligning the tax system to the specific requirements of a particular country’s growth need, as it has to balance both short-term and long-term impact of the tax policy” (p. 22). Over and above the above, much research and literature in this area of taxation is generally foreign.

### 2.6.2 Tax compliance and financial performance

According to Kintu et al. (2019), researchers have argued that most of the funds which small and medium enterprise entities give to comply with taxes are those that could have been retained in the entity for future use, to facilitate development of SMEs. It is believed that the taxes together with a complicated tax arrangement, puts an unequal burden on SMEs.

Tee1 et al (2016) believes that there is discrimination against small and medium taxpayers which follow the same complicated tax system with fellow large entities, this is because the compliance needs, price of compliance and rate of tax are all equal for both large and small entities. Reduction of compliance costs plus tax rates enhances the much-needed profitability of SMEs. This, in turn, also upswings the administration’s taxation revenue. The streamlined and rationalized provision for smaller entities has historically reduced the magnitude of what Chipeta (2012) referred to as the economy of the shadows, as well as reduced, according to Vasak (2008), the total number of non-complying properly enumerated tax-payers.

As noted by Tee1 et al. in 2016, small and medium-sized enterprises (SMEs) often find themselves navigating a burdensome regulatory landscape. This landscape is characterized by numerous regulatory agencies, multiple tax requirements, complex importation procedures, and significant port charges, all of which consistently place a heavy burden on their day-to-day operations. Many SMEs are forced to engage with a multitude of agencies, incurring substantial costs in the process. Furthermore, SMEs are a diverse group, and their variations in size and structure result in differing obligations for maintaining records, which, in turn, influence the costs associated with compliance for these businesses and the administrative tasks of revenue authorities in managing various tax obligations.

An extremely complicated regulatory tax structure and tone that is cloudy in the manner it is administered and enforced simply results into a tax compliance which is excessively difficult and many times gives a poor consequence regarding advancement of smaller entities because smaller entities are attracted to switch to formulas which result into reduced to no tax liability at all (Kintu et al 2019), result: a tax system which enforces great expense on taxpayers.

An apparently reasonably designed tax system but which is badly implemented also results into lower efficiency, higher collection charges, time wasting to both officials of tax as well as taxpayers, and reduced amount of taxation collected besides deviating optimal allocation of tax administration resources (Farzbod, 2000).

Current and earlier studies have all concluded that smaller entities aren't affected proportionately with the above noted costs. Cost of compliance of SMEs are high in comparison to those of large entities" (Weichenrieder, 2007). Several factors militate against SMEs compliance of tax, and these are identified by Farzbod (2000) as "high tax rates, Low efficiency, high collection charges, waste of time for taxpayers and the staff, and the low amounts of received taxes and the deviation of optimum allocation of resources". Other militating factors According to Yaobin (2007) against SME tax compliance are double taxation arrangements, lack of access to professional tax consultants, poor tax planning, and high cost of tax.

Iwuji (2003) is of the belief that "the government has the role of providing a conducive tax atmosphere as well as appropriate social services which support the smaller entities. This, for the case of Malawi, for example, implies improving the climate of investment for improved economic development and ensuing contribution of tax from taxpayers which is essential because many SMEs function outside the formal economy because they believe that the tax atmosphere where these SMEs operate is not favorable to their long-term survival. Such SMEs constitute unexploited revenue prospect as well as an unfair tax playing ground in several countries (International Tax Dialogue, 2007; Kintu et al 2019), because of this, there is need to bring these into the tax net too" (Tee1 et al 2016, p. 22). It can be stated that tax legislation is important to regulate and protect the business atmosphere and secure "all economic agents to establish needed social security principles while it concurrently obstructs the SME businesses with more expenses and administrative hindrances, which at the end of the day puts SMEs in worse off situation". It can be argued that large entities can easily hire experts to work on their tax matters. Per Smatrakalev (2006), "for SMEs, this is a big expectation as it results into a huge cost out of their abilities" (Shahroodi 2010, p. 3). According to Shahroodi (2010): Tax policy should be formulated with several key objectives in mind. These include establishing reasonable and logical tax rates, reducing the number of exemptions with lower monetary thresholds, enhancing the efficiency of tax authorities, ensuring a lighter tax burden for those with limited financial means, and intensifying efforts to combat corruption and tax evasion.

Effective tax guidelines should not only affect smaller entities but should also indirectly stimulate their growth. A notable example of this approach is observed in China, where tax policies have been tailored to promote financing for small and medium-sized enterprises (SMEs). This is achieved through measures like providing tax exemptions for financial institutions that offer guarantees for SME loans and granting tax deductions to market entities and venture capitalists who invest in high-tech SMEs, with deductions amounting to 70% of the investment value (Kamar, 2015).

An alternative strategy is to design a tax policy that encourages investment in human resource development and education.

According to Yaoben (2007), distinct tax organization for smaller entities are suitable program implements for decreasing tax collection cost. It's significant to be mindful of hazards of insufficient consideration relating to the manner in which SMEs are taxed. It may result, as an example, to unequal competition due to disproportionate tax execution, with inducements fashioned to reduce growth as well as to avoid tax by way of artificially dividing SMEs (International Tax Dialogue 2007). Additionally, tax policy inducements like "tax rebate for SMEs with emphasis on local sourcing of raw materials, serious in adding value to commodities for exports and other business ethics may remain used by an administration" (International Tax Dialogue 2007, p. 3). Likewise, the governing administration should raise financing for the growth of the SME industry by way of direct financial distributions and boost investment chances which should concentrate in the space of capability improvement. Kasipilai (2005) is of the view that the tax laws must continuously be streamlined, because of the following reasons: to reduce compliance expenses and secretarial expenses, to lessen ambiguity met by SME tax-payers and also to increase the levels of voluntary tax compliance. All in all, tax enforcement together with tax regimes must be kept simple, stable and expectable.

According to Atawodi et al (2012), nature of policy a nation chooses to use will rest on employment of the following two sets of implements. Firstly, use of distinct tax inclinations to back new start-ups and growth of small and medium entities. The inducements encompass the reduction of company tax tariffs, taxation holidays, tax exceptions and tax reliefs for smaller entities. The reason behind these measures is to successfully raise money using measures suitable to the nation, situations and administrative capability (Atawodi et al 2012). It can be said that less developed nations like Malawi normally struggle in the area of raising internally generated revenue for expansion. As a way of surmounting this problem, tax scholars have pondered amongst others that there is need to widen the tax net. There is an urgency in the country to deliver infrastructure and to create jobs, reduce joblessness, increase the productive segments and to also meaningfully increase public income from non-Agriculture sector.

In Nigeria, according to Small and Medium Scale Enterprises Development Agency or (SMEDAN), around 80% of SMSs die before reaching the age of 5 years. It can be stated that this type of SME death rate observed in Nigeria is characteristic of most SMEs on the African continent. Top on the list of the main causes of death of these SMEs are issues concerning tax, starting from what Kamar (2015) has termed "multiple taxations to massive burdens of tax amongst other matters" (p. 22). As observed above, in many tax policies of African nations, the small and medium entities are frequently regarded in similar manner as big entities. The situation is no different in some developed economies, take the case of the United Kingdom, for example, According to Miller and Wongsaroj (2018), in spite of many nations giving a mere "lip service to smaller businesses, the evidence suggests that tax regimes the world over favour larger corporations. Miller and Wongsaroj (2018) further makes the following observations relating to the SME industry versus the system of tax in the United Kingdom:

> Take the UK's archaic business rates tax as an example. This tax – which unbelievably was created in Shakespeare's day 400 years ago – creates a warped hierarchy where an independent high-street bookshop ends up paying this tax at a far higher percentage of their annual turnover than the global online e-commerce giants, who minimise their own

> business rates as they have no physical shop front and low-cost warehousing. Compound this with big companies creating exotic structures to minimise tax further. This jarring disconnect means that Small & Medium Businesses – the heroes of all economies who create two-thirds of all jobs, the engine of prosperity and social cohesion in communities – face another giant hurdle in tax when it comes to their size.

It can be said that SMEs small size makes them exceptional. It can also be argued that when the government tax policies are crafted, the unique qualities of SMEs ought to be considered. Levying of tax to especially SME matters are how the crafted tax policy should be considered to boost the progress of these SMEs as well as the best ways to implement the policy (Kamar 2015). Kamar (2015) further argues that what is ignored is the importance of SMEs "as a mechanism of economic growth and development" (p. 3). SMEs are considered as small formations which have little effect on an economy of the nation. Nevertheless, when favorable atmosphere is there for the SMEs to develop under favorable tax regulation, this SME segment has the maximum inclination to transform the economy of a nation.

Holban (2007) observed that "tax can and does fund the growth and prosperity of a nation by way of the following three foundations: It need be able to generate sufficient funds for financing public services and social transfers at a high level of quality, it should offer incentive for more employment and for an efficient and lasting use of natural resources, finally it should be able to reallocate income". However, for SMEs, taxation should be executed in such a manner that the needs and incomes of SMEs is protected. It is therefore important that profit is ploughed back to the SMEs so that their businesses can grow.

A good taxation policy should be crafted in such a way as to discourage smaller entities to stay in non-formal segment or dodge taxation outflows. Kintu et al (2019) makes the observation that many small and medium entities in Africa prefer to remain in the informal segment since the apparent benefits are greater than the apparent costs. SMEs do not believe that their tax payments are used properly by their governments, and besides, tax compliance costs are considered to be too high, hence not encouraging compliance. Tax administrations are also not encouraged to collect tax from SMEs due to the high collection costs from SMEs by the tax authorities, as their means of collection are generally rare, at times outweighing the proceeds originated from SMEs" (Stem and Barbour 2005).

All in all, tax strategies should aim at bringing in all entities capable of paying tax “into the tax net, with a graduated rate that should ensure that the bigger organizations pay their own share while the small and medium enterprises are given savings incentives” (Miller et al 2018, p. 7). Any “good, efficient and effective administration of a tax system must be fundamental to a nation’s happiness” (Atawodi et al 2012, p. 8). This explains why Baurer (2005) observes “that the tax administration must provide an even playing field for business by making sure that the tax paying entities pay taxes accordingly” (p. 18).

According to Atawodi et al (2012), the thinking behind any good system of tax must have at-least two of the following major aspects: “The Ability-to-Pay Principle and the Equal Distribution Principle” (Atawodi et al 2012, p. 8).  “Ability-to-Pay” concept positions that a taxpayer needs to be taxed in line with the taxpayers’ capacity to remit tax. The “Equal distribution” principle advocates that revenues, together with the financial dealings of taxpayers need to be “taxed at a fixed rate”, meaning, taxpayers “who earn more and spend more” must therefore be expected to pay more tax but without necessarily paying at a high tax rate”. (Atawodi 2012, p. 9).

Tax compliance definition is considered to be complex According to Martin (2010). Not to be overly difficult and simply put, tax compliance may be defined According to Matin (2010) as “the fulfilment of all tax obligations as specified by the law freely and completely. Studies have demonstrated that SMEs have suffered from excessive regulatory burdens” (Pope and Abdul 2008, p. 7).

Smaller entities “makes the issue of tax compliance one of particular importance” due to their size and nature (Atawodi et al 2012, p. 9). More especially “because many smaller entities do not have good access to capital and do not have adequate capability to conform to various and complex tax laws (Atawodi et al 2012, p. 9). According to Martin (2010), excessively high compliance costs can lead to undesirable outcomes, such as tax avoidance, tax fraud, and reduced investment, as these costs diminish a country's attractiveness in terms of taxation.

Furthermore, noncompliance with tax obligations can take various forms, including failing to submit tax returns within the stipulated timeframe or not submitting them at all, understating income, overstating deductions, and not paying assessed taxes by their due dates. Noncompliance may also encompass a complete failure to meet calculated tax obligations.

A study by Fagbemi et al (2010) showed that tax evasion is a common one in underdeveloped nations; tax noncompliance is common in the underdeveloped nations and it hampers progress, thus resulting into stagnant economy and stagnating societal and fiscal difficulties".

A study by Chipeta (2002) observed that the main determinant of tax evasion was high rates of tax. Chipeta (2002) also observed "that high taxation rates increase the tax burden of taxpayer" (p. 3) besides, at the same time, decreasing their disposable income, there-by increasing the chance of tax evasion by the taxpayer. According to Tee1 et al (2016):

> Numerous academics have explored the inquiries stemming from this body of literature, particularly focusing on the lack of responsiveness in tax location decisions when it comes to variations in tax disparities between different jurisdictions. The issue of inadequate coordination between personal and corporate tax systems has also been examined.
>
> To address market inefficiencies, governments are urged to reassess any biases in their tax systems that may disadvantage entrepreneurs and to formulate tax policies aimed at fostering entrepreneurship. It is essential that these policies are crafted with care to mitigate any unintended negative consequences. Notably, marginal tax rates have been found to exert a substantial and quantifiable influence on the growth of small and medium-sized enterprises (SMEs) (p. 32).

The marginal rate of tax stated above has been defined by Tee1 et al (2016) "as the amount of tax paid on an additional currency of income" (p. 3). It can therefore be stated that increasing tax on SMEs constrains growth of these smaller entities.

## 2.7 Current study's theoretical framework

### 2.7.1 The Tax Compliance-Financial Performance Framework for Malawian SMEs

The purpose of this research study is to assess SME perceptions of the impact of income tax compliance level on financial performance of SME enterprises in Malawi, for the year ended 31st December 2022. The study found out if SMEs in Malawi, pay fully, partially or not at all, income tax charged on them by the Malawi Revenue Authority. The other aim of this study was to evaluate the effect, such observed level of income tax compliance has on perceived financial performance of these SME's. Financial performance was measured by way of respondent's perception of level of sales and profitability, whether in their opinion they believe that sales and related profitability of their SMEs are high or low, on a 5-point likert scale.

The industry in Malawi is made up of mostly small and medium sized entities (OECD 2012). Small and Medium-sized Enterprises (SMEs) are considered as crucial engines of economic growth, and their financial performance is intrinsically tied to tax compliance. The tax compliance behavior of Small and Medium-sized Enterprises (SMEs) is pivotal not only for government revenue but also for their own financial performance This section presents a comprehensive theoretical framework that integrates the four key income tax compliance theories which relate to SME financial performance: Institutional Theory, Behavioral Economics, Tax Complexity Theory, and Tax Morale Theory to elucidate the intricate relationship between SME tax compliance and financial performance in contemporary contexts.

Tax can be defined as obligatory, unreciprocated outflows to general government, or, put it the other way, tax can be defined as “obligations made by governments on the income and wealth of persons under their jurisdiction” (OECD 2012, p. 248)). Scholars have noted that it is important “for Government and its various departments to bring together money from various sources in order to finance shared outflows” (Chafuwa et al, 2014, p. 6.) It can therefore be stated that Governments cannot function properly without money from the fiscal space in form of taxes. It can also be stated that income tax forms one of the major sources of money for any Government.

This research follows the quantitative method approach because it measures SME perceptions of the level of income tax compliance as well as finds out if a relationship exists between two variables: perceived level of income tax compliance on one hand and the impact such perceived level has on financial performance (financial performance was measured in terms of perceived sales and profitability) on the other hand by way of perceptions of respondents on a three to five point likert scale. The facts and data around this phenomenon are mere perceptions which are then expressed numerically on a 3 to 5 point likert scale, as a result, and analyzed using STATA. It can be stated that if it is not absolute figures, then it is not quantitative data and if it is not quantitative in nature then it is quantitative.

It can be stated that if there are mere perceptions and feelings involved, then it’s not quantitative research by nature, but qualitative research. Some research naturally offer itself to quantitative scrutiny simply because it is numerical in nature, for example, the amount of profit an entity made the last financial year. It is however possible to analyze, in a statistical manner, certain research which is not quantitative in nature. For example, turning perceptions and feelings into numerical numbers. If, for example, a researcher wants to find out whether tax payers generally found it wrong not to pay income tax, then, According to Sekaran (2003), it is possible to ask them to give their relative consent on a three, five or even a seven-point scale. On a five-point likert scale, 1 (one) can be designated as strongly disagree, 2 (two) as disagree, 3 (three) as neutral, 4 (four) as agree and 5 (five) as strongly agree. The seven-point scale can also include slightly agree/disagree, besides those depicted in the five-point scale. Such 5 or 7 point scales are termed "Likert" scales (Sekaran (2003)). These enable declarations of opinion to be transformed into numerical data. It can be stated that as a result of the development of Likert scales, it now can be said that most qualitative occurrences can be studied through quantitative techniques.

According to OECD (2012), better tax compliance of SMEs is "proportionately related to their long-term sustainability and growth". Thus, it can be stated that the more SMEs comply with their income tax obligations, the higher the sales and the higher the related profitability. It can also be stated that better tax compliance is not necessarily a solution to all the problems faced by SME enterprises, but according to OECD (2012), income tax compliance clearly plays a critical role to SME's overall long-term health and financial performance in terms of sales and related profitability.

It is therefore presumed, for the purposes of this study, that the financial performance of SME entities in terms of sales and profitability, which are identified as variables of utmost interest, benefits more and to a greater extent depends on good compliance with income tax principles. It is therefore hypothesized that the higher the level of income tax compliance, the better the financial performance in terms of sales and profitability of SMEs and vice-versa. For example, if the Malawi Revenue Authority is kept happy at all times by way of good income tax compliance, then the SME owners, managers and associated employees should have sufficient time and freedom to concentrate on their SME trading activities, thereby enhancing the financial objectives of the related SMEs, and in the process, enhancing their overall long term financial health. The SMEs will be operating freely and openly, advertising their goods and services at will, all days, as opposed to operating underground, under the carpet, away from the eyes of the tax man. Besides, the SMEs will be considered as good corporate citizens and their relationship with the society will be sound, which in turn will enhance their sales and related profitability.

On the other hand, if there is no income tax compliance and the Malawi Revenue Authority (MRA) is always at the door of an SME entity with actual or threatened litigation and income tax demand letters together with tax audits and related penalties which comes as a result of uncovered non-compliance, the entity will not only suffer bad publicity which is bad for it both in the short and long run, but will also not trade freely, besides possible loss of time and money through long meetings with tax authorities and tax penalties. Most likely, customers of good standing in society together with good corporate entities will shun trading with such SME entities.

It can therefore be theorized that financial performance is dependent on income tax compliance, on the other hand, income tax compliance is independent of financial performance. Thus, financial performance is identified as a *dependent variable* and income tax compliance as *an independent variable.*

*Intervening variables* which are variables to help explain the causal relationship between financial performance (dependent variable) and level of income tax compliance (independent variable) can be said to be the tax deterrence instrumentation together with related tax morale. Tax deterrence measures can be said to be those physical measures put in place to punish tax offenders. Deterrence theory is based on the assertion that income tax compliance behavior "is enhanced by elements like frequent tax audits, punitive tax rates for tax offenders and other tax punishments for tax offenders" (Malik & Younus 2019, p. 13). Tax deterrence model takes a taxpayer as a "rational economic agent, that considers the costs (determined by probability of detection and related penalties for fraud) and benefits (determined by tax rate) of evading taxes, and therefore selects to be non-compliant where the apparent costs of complying are higher than those of non-compliance" (Malik & Younus 2019, p. 13). Tax deterrence instruments include high tax rates, actual and threatened tax audits and harsh punishments for tax offenders. Based on tax deterrence model, it can be hypothesized that where there is a low probability of tax audits and a low probability of punitive tax penalties and related punishments regarding tax misconduct, there will be a higher probability of income tax non-compliance. Conversely, where the prospect of income tax audits is high that will result in higher prospect of discovery which will result in severe punishments, there will be high tax compliance (Fjldstad, Schulz-Hezenberg and Sjusen, 2012 Mazzolini et al 2017, Dularif et al 2019).

The related tax morale takes into account "behavioral aspects like attitudes, perceptions, and moral judgments" (Dularif et al 2019). This takes into account "ethical checks and values which have the ability to prevent taxpayers from evading their rightful tax" (Dularif et al 2019, p. 37).

This brings in the Social Psychology theory, as the second tax compliance deterrence theory. This theory is premised on the basis that “taxpayers formulate their behavioral intents based on two elements – their personal norms and influences together with their social effects (McKerchar & Evans, 2009). These two basic elements are commonly agreed to play vital roles in defining tax compliance levels (Ronan 2007, OECD, 2018).

Personal norms relate to taxpayers’ ethics, tax values, tax attitude, and tax morale, these have a bearing on taxpayers’ compliance.

It can therefore be theorized that involvement in schemes of tax evasion results in feelings of anxiety, guilt or negative self-image in the mind of taxpayers. Being afraid of societal stigmatization as one of the factors deterring tax fraudulent activities confirms the conviction that in general, “tax compliance is taking place in the social confines” as well as existence of what is to be termed the “social norms effect on tax compliance conduct” (Kirchler, 2007, p. 4),

It is theorized, as a second intervening factor, that SME taxpayers are likely to observe correct tax payments where their tax morale is high, for example, where they have trust in their national Government and are happy with the way they perceive that their national Government spends their tax money, where they perceive overall low tax evasion in the industry, where they perceive that they are highly regarded in society and where they perceive that the current income tax system is not burdensome on their SME entities and vice versa.

Age, gender and level of education act as *moderating variables*, a variable which can increase, decrease, contradict, or else change the relationship between the two variables of greatest interest, the independent, in this case level of income tax compliance, and the dependent variable, in this case financial performance in terms of sales and profitability of SMEs.

It is assumed, for the sake of this study, that older tax payers will be more tax compliant and so result into higher sales and higher profitability and vice versa. It is also assumed that females are more tax compliant than males. Females are generally considered as more careful, guarded and restrained in what they do as opposed to males.

Regarding level of education, it is assumed that more educated tax payers are more tax compliant than the less educated ones as the more educated ones should easily understand and interpret tax principles, which are considered as complicated by many tax payers.

The variables can then be extracted from the thesis title and the preceding paragraph and be broken down as follows:

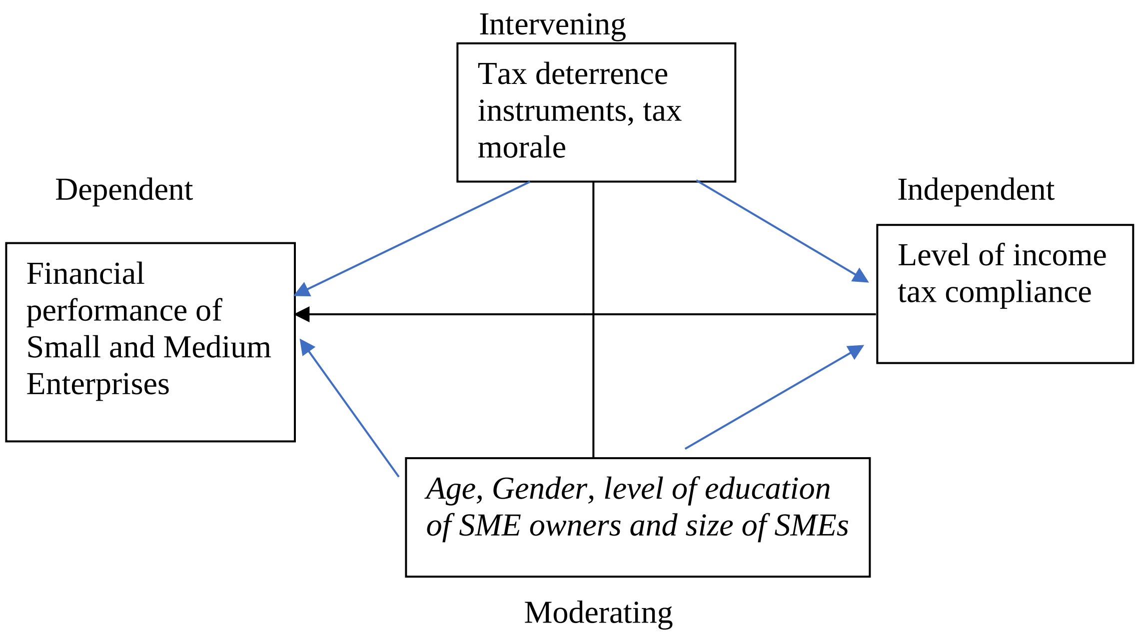
- Dependent variable: Financial performance of SME entities

- Independent variable: Income tax compliance
- Moderating variables: Age, gender and level of education of SME owners
- Interveningvariables: Tax deterrence instruments together with related tax morale

A schematic diagram of the above identified variables is depicted in Figure 3.2 below.

**Figure 3.1**

*The Tax Compliance-Financial Performance Framework for Malawian SMEs*




**Library databanks used during this study include:** Google; Google scholar; Researchgate.net; JSTOR; academia.edu and www.uscourts.gov.

**Key terms used include**: Tax compliance, tax theory, tax bases, tax economic deterrence; fiscal psychology theory; tax evasion; tax avoidance.

## 2.8 Conclusion

2.8.1 Factors Influencing Tax Compliance Among SMEs

Taxpayers have various motivations for paying taxes, with the most prominent being the presence of economic deterrence mechanisms, such as fines, audits, and associated penalties imposed by tax authorities (Ortega and Sanguinetti, 2013). Under this tax model, taxpayers make decisions about whether and to what extent they should evade taxes, akin to how they approach any risky decision or gamble, by maximizing expected utility (Ortega and Sanguinetti, 2013). In this context, tax evasion is inversely related to the probability of detection and the severity of potential penalties. Generally, SMEs comply with income tax regulations not out of voluntary choice but to avoid stringent deterrence measures.

Tax compliance decisions of entities are influenced by factors categorized into various theories. Five groupings of income tax compliance theories, identified by the OECD department of Income Tax Administrators, include "Deterrence, Social Psychology, Fiscal Exchange, Comparative Treatment, Political Legitimacy, and Trust in Government." Taxpayer compliance is typically analyzed from two theoretical perspectives: economic deterrence and a broader social psychological theory (Frey & Feld, 2002; Tusubira and Nkote, 2013; Chauke et al., 2016)

Devos (2007) defines "tax economic deterrence" as a form of reflective intimidation by presenting threats that wrongdoers will face punishment when a wrong has been committed. This concept applies to situations where an actual or perceived threat from tax authorities dissuades a taxpayer from engaging in conduct that would otherwise be perceived as susceptible to tax evasion. The theory assumes that taxpayer compliance behavior is influenced by factors like tax rates, penalties for fraudulent tax behavior, and the likelihood of being detected.

The economic deterrence model views taxpayers as rational economic agents who weigh the costs, determined by the probability of detection and penalties for tax fraud, against the benefits derived from evading taxes. Taxpayers opt for non-compliance when the perceived costs of compliance outweigh those of non-compliance (Walsh, 2012). Consequently, in settings with a low likelihood of tax audits and mild penalties, tax evasion is more likely. Conversely, in cases with a high likelihood of audits leading to severe penalties, few taxpayers are inclined to evade taxes (Fjldstad, Schulz-Hezenberg, and Sjusen, 2012). This economic model supports strict audits and high penalties to deter tax non-compliance.

However, recent studies, such as Doerrenberg and Peichl (2018), argue that tax compliance is driven by factors beyond extrinsic economic deterrence, such as tax rates, penalties, audit probabilities, and enforcement measures. Economic deterrence alone cannot explain high levels of tax compliance observed in developed countries. Intrinsic and non-monetary factors, collectively referred to as "tax morale," also play a significant role. Tax morale encompasses ethical considerations, societal norms, and the reciprocity principle, where individuals are more likely to comply when they perceive that the government provides public goods and services effectively (Doerrenberg and Peichl, 2018).

Tax morale is shaped by various influences, including feelings of guilt, preferences for honesty, moral sentiments, cultural factors, and societal norms. Reciprocity, which involves paying taxes in exchange for quality government services, is considered a key motivator for tax compliance. Taxpayers may be more inclined to evade taxes if they believe tax evasion is common and may be more compliant when they see their fellow taxpayers fulfilling their tax obligations honestly.

### 2.8.2 Tax Compliance and the Financial Performance of SMEs

In smaller economies like Malawi, SMEs are recognized as pivotal contributors to economic progress and industrial development (Aryetey, 2004; Oludele, 2012; Miller et al., 2018). These SMEs are vital in generating employment opportunities, fostering fiscal growth, and alleviating poverty in developing nations (Aryetey, 2004; Oludele, 2012; Miller, 2018). However, SMEs often face challenges when dealing with governmental agencies and tax authorities, particularly in emerging economies like Malawi. Many of these challenges stem from poorly formulated tax policies and uncertainty about future policy changes.

A study by Mnewa et al. (2008) locally revealed that unfavorable tax policies hinder several SMEs from achieving desired growth and profitability levels. Researchers, including Kintu et al. (2019), have found that the funds SMEs allocate for tax compliance could be better utilized to support their growth. The tax system's complexity, along with high compliance costs and tax rates, places an unequal burden on small and medium enterprises. Reducing compliance costs and tax rates can significantly enhance SME profitability

An effectively designed tax system that is poorly implemented can result in lower efficiency, increased collection costs, and wasted time for both tax officials and taxpayers. It can also lead to a reduced amount of tax revenue collected and suboptimal allocation of tax administration resources (Farzbod, 2000). Existing studies have consistently shown that smaller entities, like

SMEs, are disproportionately affected by these costs, with higher compliance costs compared to larger entities (Weichenrieder, 2007).

Several factors hinder tax compliance among SMEs, including high tax rates, low efficiency, high collection costs, time wastage for both taxpayers and tax officials, and suboptimal allocation of resources (Farzbod, 2000). Other challenges identified by Yaobin (2007) include double taxation arrangements, limited access to professional tax consultants, and poor tax planning.

A study by Fagbemi (2010) demonstrated that tax evasion is prevalent in underdeveloped nations and hampers progress, leading to stagnant economies and societal and fiscal difficulties. Another local study by Chipeta (2002) highlighted that high tax rates increase the tax burden on taxpayers, decrease their disposable income, and consequently raise the likelihood of tax evasion. In summary, tax compliance challenges can impede the progress of SMEs in developing countries,

# Chapter 3: Research Method

## 3.1 Introduction

This chapter provides a detailed explanation of the specific research methodology chosen for the current study. As a matter of emphasis, the chapter outlines the research philosophy, research design, population of the Study, sample and sampling procedure, research instrument, procedure for data collection, and the method of data analysis. Reliability of the research instrument and ethical considerations are also considered.

## 3.2 Research purpose

The primary purpose of this research is to assess and analyze the perceptions of SMEs in Malawi regarding the impact of income tax compliance on their financial performance during the year ended 31st December 2022. This study aims to investigate the multifaceted relationships between income tax compliance practices and the financial well-being of Small and Medium-sized Enterprises (SMEs) operating in the Malawian business landscape, guided by the theoretical framework of four tax theories: Institutional Theory, Behavioral Economics, Tax Complexity Theory, and Tax Morale Theory.

The study follows the quantitative method approach because the research instrument captured perceptions of SMEs regarding their level of sales and their impact on their sales and profitability, on a 5-point likert scale. As per the American Pschological Association, quantitative research, often employed in social sciences, economics, and various scientific fields, is a systematic empirical approach that aims to collect, analyze, and interpret numerical data to understand, describe, and make inferences about a specific phenomenon or the relationships between variables. In quantitative research, data is typically gathered through structured surveys, experiments, or the analysis of existing datasets, with the ultimate goal of providing a precise and objective representation of the research subject.

The study also found out if a relationship exists between two identified variables of interest: perceived level of income tax compliance on one hand and the impact such perceived level of income tax compliance has on financial performance in terms of sales and profitability. Data was obtained through perceptions on a 5-point likert number scale. These (likert scale) numbers were subsequently captured, cleaned and analyzed using descriptive statistics, through a statistical package, STATA. Specifically, this research endeavored to achieve the following:

### 3.2.1 Examining the awareness and understanding of income tax regulations

The study sought to gauge the level of awareness and comprehension among SMEs in Malawi regarding income tax regulations applicable during the year ended 31st December 2022. It aims to understand whether SMEs possess a clear understanding of their tax obligations and the implications of non-compliance.

Examining the awareness and understanding of income tax regulations in Malawi is a crucial endeavor for various reasons. Income tax regulations play a pivotal role in the financial well-being of individuals, businesses, and the overall economic development of the country. Here, we'll delve deeper into the importance of studying the awareness and understanding of income tax regulations in Malawi.

Revenue generation: Income tax is a significant source of revenue for the Malawian government. It is used to finance public infrastructure, education, healthcare, and other essential services. Understanding how well citizens and businesses are aware of and comply with these regulations is essential to ensure that the government collects the revenue it needs to operate effectively.

Equity and fairness: A well-structured income tax system aims to distribute the tax burden fairly among individuals and businesses. Understanding the awareness and understanding of these regulations helps to identify if the system is fair and if high-income earners are paying their fair share. This, in turn, promotes social and economic equity.

Compliance and enforcement: A significant aspect of tax regulation awareness is compliance. When citizens and businesses understand the regulations, they are more likely to comply voluntarily. This reduces the need for aggressive tax collection methods, which can be costly and counterproductive. Thus, studying awareness can inform tax authorities on how to improve compliance rates and enforcement strategies.

Economic development: A well-regulated and effectively enforced income tax system can foster economic development. It can incentivize individuals and businesses to invest and participate in the formal economy. This not only generates revenue but also creates jobs and stimulates economic growth.

Public Trust: Taxpayers are more likely to pay their taxes willingly when they trust that the system is transparent, fair, and the funds are being used for public welfare. Awareness and understanding of income tax regulations contribute to building public trust in the government and its fiscal policies.

Reduction of tax evasion: Low awareness and understanding of income tax regulations can lead to tax evasion. By examining this awareness, governments can identify areas where education and information campaigns are needed to reduce tax evasion, which can be detrimental to the country's finances.

Policy development and reforms: Research on awareness and understanding of income tax regulations can provide valuable insights for policymakers. It can help identify areas where regulations are unclear, complex, or outdated, and thus in need of reform. Effective policies depend on a clear understanding of the current situation.

International relations and investment: Malawi is a part of the global economy, and its tax regulations need to be aligned with international standards. High awareness and understanding of these regulations can make the country more attractive to foreign investors and facilitate international economic cooperation.

Education and capacity building: Understanding the level of awareness of tax regulations can inform educational and capacity-building initiatives. These programs can target specific groups or regions where awareness is low, helping to improve tax literacy.

Data and economic planning: Data on tax awareness and compliance can be invaluable for economic planning. It provides insights into the tax base, revenue projections, and the impact of fiscal policies on different income groups.

### 3.2.2 Evaluate the impact of income tax compliance on financial performance

The research aims to assess how income tax compliance, including tax planning, payment accuracy, and adherence to deadlines, influences the financial performance of SMEs in Malawi. It will examine whether compliance positively or negatively affects key financial indicators such as profitability, liquidity, and solvency.

Evaluating the impact of income tax compliance on financial performance is a critical aspect of financial management for both individuals and businesses. This analysis provides insights into the relationship between adhering to tax regulations and overall financial well-being. Here are some key points to consider when examining this impact.

Reduce tax liabilities: One of the most direct ways income tax compliance affects financial performance is through the reduction of tax liabilities. When individuals or businesses comply with tax regulations, they pay the required amount of taxes, avoiding penalties, fines, or legal issues. This means they retain more of their earnings, which can be reinvested or used for other financial purposes, such as debt reduction or savings

Enhanced reputation: Tax compliance is often associated with financial integrity and responsible financial management. Individuals and businesses that consistently comply with tax regulations tend to have a better reputation in the eyes of stakeholders, including customers, investors, and financial institutions. This can lead to increased trust and opportunities for growth or financing.

Avoidance of legal issues: Non-compliance with income tax regulations can result in legal troubles, including audits, fines, and even legal actions. These legal issues can be financially draining, both in terms of direct financial penalties and the costs associated with legal representation. Ensuring tax compliance helps avoid these costly legal entanglements.

Improved access to credit: Financial institutions often consider a borrower's tax compliance history when evaluating creditworthiness. Those who have a clean compliance record are generally more likely to secure loans at favorable terms, which can be instrumental in expanding a business or pursuing personal financial goals.

Stable cash flows: Tax compliance entails proper record-keeping and financial discipline, which can contribute to stable cash flow management. Predictable cash flow is essential for financial planning, investment, and debt management. Compliance ensures that there are no unexpected tax-related disruptions to cash flow.

Investor and shareholder confidence: For businesses, income tax compliance is closely scrutinized by investors and shareholders. Complying with tax regulations demonstrates responsible corporate governance and ethical business practices. This, in turn, can attract more investors and shareholders, potentially leading to increased capital and support for expansion or innovation.

Operational efficiency: Complying with tax regulations often requires good record-keeping and accounting practices. This can lead to improved operational efficiency as a business's financial processes become more organized and streamlined. Better financial management can positively impact a company's bottom line.

Tax credit and incentives: Some tax systems offer credits and incentives for individuals and businesses that engage in specific activities, such as research and development or energy conservation. By being tax-compliant, entities can access these benefits, further bolstering their financial performance.

Strategic planning: Income tax compliance also necessitates a deep understanding of tax regulations. This knowledge can be harnessed strategically to optimize financial performance. Individuals and businesses can take advantage of tax planning opportunities to legally reduce their tax burden.

Economic stability: On a broader scale, widespread income tax compliance contributes to economic stability by ensuring that governments have the revenue they need to provide public services and maintain infrastructure. This, in turn, fosters an environment where businesses can thrive and individuals can pursue their financial goals with confidence.

### 3.2.3 Identify challenges and barriers to tax morale in compliance

This research aims to identify and analyze the challenges and barriers faced by SMEs in Malawi when striving for income tax compliance. It will investigate factors such as tax complexity, administrative burdens, and resource constraints that may impede SMEs' ability to meet their tax obligations effectively.

Identifying the challenges and barriers to tax morale in compliance is crucial for tax authorities and policymakers aiming to boost voluntary tax compliance and enhance public trust in the tax system. Tax morale refers to the willingness of individuals and businesses to pay taxes not only because of legal obligations but also because they believe it is the right thing to do for the common good. Understanding the obstacles to tax morale can help address them effectively. Here are some common challenges and barriers.

Perceived corruption: High levels of corruption within tax authorities and government institutions can erode tax morale. When taxpayers believe that their tax payments will be siphoned off by corrupt officials or misused, they may become less willing to comply.

Complex tax laws: Tax codes that are overly complex, difficult to understand, or subject to frequent changes can confuse and frustrate taxpayers. This complexity may lead to unintentional errors, discouraging compliance.

Uneven enforcement: When tax laws are enforced unevenly or selectively, it can create a sense of unfairness. Some individuals or businesses may feel they are being unfairly targeted while others evade taxes with impunity. This inequity can diminish tax morale.

Lack of transparency: Transparency in the tax collection process is essential for building trust. A lack of transparency in how tax revenues are collected, allocated, and spent can lead to suspicion and reduced tax morale.

Inadequate public services: If taxpayers perceive that the government is not efficiently using tax revenues to provide essential public services like healthcare, education, and infrastructure, they may question the value of their tax payments, leading to decreased morale.

High tax burden: When tax rates are perceived as too high, taxpayers may feel overburdened. This can lead to resentment and reduced compliance as individuals and businesses seek to minimize their tax liabilities.

Lack of accountability: When government officials are not held accountable for mismanagement or misuse of tax funds, it can undermine tax morale. Taxpayers need to see that those responsible for managing public finances are answerable for their actions.

Cultural and social factors: Cultural attitudes toward taxes, especially in societies with a history of tax evasion, can significantly affect tax morale. Social norms and attitudes toward tax compliance within a community can either encourage or discourage adherence to tax laws.

Economic conditions: Economic instability, high unemployment, and economic downturns can decrease tax morale. Taxpayers facing financial hardships may be less willing to pay taxes, as they perceive their financial struggles as more pressing.

Lack of tax payer education: Insufficient taxpayer education and awareness campaigns can contribute to low tax morale. Many people may not fully understand their tax obligations, the benefits of compliance, and the consequences of non-compliance.

Inefficient tax administration: Delays, bureaucracy, and inefficiencies in the tax collection process can frustrate taxpayers and reduce their willingness to comply. A smooth and efficient tax administration process is crucial for maintaining tax morale.

Perceived inequality: Growing income inequality can lead to resentment among the less affluent, who may feel that the wealthy are not paying their fair share of taxes. This perception of inequality can undermine tax morale.

Lack of public engagement: When governments fail to engage the public in tax related decision-making processes or show receptiveness to their concerns, it can reduce trust and tax morale.

To enhance tax morale and encourage voluntary tax compliance, governments and tax authorities need to address these challenges and barriers systematically. This may involve implementing anti-corruption measures, simplifying tax codes, improving transparency, and demonstrating the effective use of tax revenues in public services. Additionally, taxpayer education and engagement campaigns can help build understanding and support for the tax system, ultimately fostering a higher level of tax morale.

### 3.2.4 Explore the role of tax morale in SME income tax compliance

The study intends to explore the role of tax morale—the intrinsic motivation and willingness to comply with tax obligations—among SMEs in Malawi. It seeks to understand how tax morale influences compliance behavior and, consequently, the financial performance of these enterprises.

The role of tax morale in small and medium-sized enterprise (SME) income tax compliance is a critical factor in the overall success of tax collection and the growth of these businesses. Tax morale refers to the willingness of individuals and businesses to pay taxes voluntarily, not just due to legal obligations but also because they believe it is the right thing to do for the common good. Here, we'll explore the significance of tax morale in SME income tax compliance.

Voluntary compliance: SMEs often operate with limited resources and may not have the same level of oversight as larger corporations. Tax morale plays a pivotal role in motivating SMEs to voluntarily comply with income tax regulations, even when enforcement and monitoring mechanisms are not as stringent. When SMEs have a strong sense of tax morale, they are more likely to meet their tax obligations without the need for heavy-handed enforcement.

Economic growth: SMEs are typically major contributors to a country's economic growth and job creation. When SMEs comply with income tax regulations, governments can collect the necessary revenue to fund public services and infrastructure, which, in turn, creates a conducive environment for SMEs to thrive.

Fostering Trust: A high level of tax morale among SMEs fosters trust between business owners and tax authorities. When SMEs believe that tax regulations are fair and that their contributions are being used to benefit society, they are more likely to comply willingly. This trust can lead to a more collaborative relationship between SMEs and tax authorities.

Reputation and business relationships: SMEs often rely on strong relationships with suppliers, customers, and financial institutions. A reputation for tax compliance can enhance these relationships, making it easier for SMEs to access credit, attract partners, and secure customers.

Reduced risk: Non-compliance with income tax regulations can lead to severe penalties, fines, and even legal action. SMEs with high tax morale are more likely to avoid these risks, thus safeguarding their financial stability and long-term viability.

Level playing field: When SMEs perceive that larger businesses or competitors are evading taxes, it can create a sense of unfair competition. Tax morale motivates SMEs to maintain a level playing field by complying with tax regulations, ensuring fair competition in the marketplace.

Government support: Tax morale can influence government support programs for SMEs. Governments are more likely to invest in and support SMEs that are known for their tax compliance, creating opportunities for growth and development.

Stimulating entrepreneurship: High tax morale encourages entrepreneurship by creating an environment where individuals are more willing to start and expand their businesses. Entrepreneurs who perceive tax compliance as a moral obligation are more likely to enter the formal economy.

Efficient resource allocation: When SMEs have strong tax morale and are confident in the fairness and effectiveness of the tax system, they can focus on their core business activities instead of dedicating resources to complex tax evasion schemes.

Community and social responsibility: SMEs often play a crucial role in local communities. High tax morale not only benefits the government but also reflects a sense of social responsibility, as SMEs contribute to local development and public welfare.

In conclusion, tax morale is a critical factor in SME income tax compliance. It goes beyond legal obligations and can be a powerful motivator for SMEs to voluntarily meet their tax responsibilities. Encouraging and nurturing tax morale in the SME sector not only ensures that governments collect the revenue they need but also fosters economic growth, trust, and responsible business practices in the SME community.

### 3.2.5 Assess the efficacy of tax support mechanisms

This research also evaluates the effectiveness of government-provided tax support mechanisms, including tax education and advisory services, in assisting SMEs with income tax compliance. It investigates whether such mechanisms positively impact compliance levels and financial performance.

Assessing the efficacy of tax support mechanisms in Malawi is crucial for understanding how well the government and relevant organizations are helping taxpayers comply with tax regulations, facilitating revenue collection, and promoting economic development. Tax support mechanisms encompass a range of initiatives and services aimed at providing guidance, assistance, and incentives to individuals and businesses. Here, we will evaluate the effectiveness of these mechanisms in Malawi.

Taxpayer education and awareness: Tax support mechanisms in Malawi often include taxpayer education and awareness campaigns. These initiatives provide information and guidance to taxpayers about their obligations and the benefits of tax compliance. An assessment should evaluate whether these campaigns have succeeded in increasing taxpayer knowledge and fostering a culture of compliance.

Simplification of tax regulations: An effective tax system should have straightforward and understandable tax laws. The assessment should examine whether there have been efforts to simplify tax regulations in Malawi and whether such simplification has led to improved compliance.

Tax advisory services: Tax support mechanisms may involve providing advisory services to taxpayers, especially small businesses and individuals. The evaluation should assess whether these services are readily available, accessible, and effective in addressing taxpayer queries and concerns.

Incentives and benefits: Malawi may offer tax incentives and benefits to certain groups, sectors, or regions. An assessment should analyze the impact of these incentives on promoting economic activities, job creation, and revenue collection.

Compliance software and tools: Assessing the provision and effectiveness of tax compliance software and tools can provide insights into the efficiency and accuracy of tax reporting and payment systems.

Customer service and responsiveness: Effective tax support mechanisms should include responsive and helpful customer service. The evaluation should consider whether tax authorities in Malawi are accessible and responsive to taxpayer inquiries and issues.

Taxpayer assistance centers: The existence and effectiveness of taxpayer assistance centers should be examined to determine whether they facilitate tax compliance and help resolve taxpayer concerns.

Anti-corruption measures: Tax support mechanisms should include measures to combat corruption and bribery within tax administration. The assessment should evaluate whether such measures have been implemented and their effectiveness in reducing corrupt practices.

Electronic filing and payment system: Assessing the adoption and usability of electronic filing and payment systems can gauge the convenience and efficiency of tax compliance in Malawi.

Capacity building: The assessment should consider the extent to which tax support mechanisms provide training and capacity-building programs for tax officials, ensuring that they have the knowledge and skills to enforce tax regulations effectively.

Public awareness and trust: An effective tax support system should also contribute to building public awareness and trust in the tax system. The evaluation should explore whether taxpayers trust that their contributions are used for the common good and whether they see the benefits of compliance.

Economic impact: The assessment should analyze the economic impact of tax support mechanisms, considering their role in revenue collection, job creation, and overall economic development in Malawi.

Legal and regulatory framework: Evaluating the legal and regulatory framework governing tax support mechanisms can help identify any legal barriers or limitations that may be hindering their efficacy.

Feedback mechanism: Assessing the presence and functionality of feedback mechanisms, where taxpayers can provide input on the tax system and tax support initiatives, can help identify areas for improvement.

In conclusion, evaluating the efficacy of tax support mechanisms in Malawi is essential for ensuring a fair and efficient tax system. It should focus on improving compliance, fostering economic growth, building trust, and promoting responsible financial practices among taxpayers and tax authorities. Such assessments can guide the refinement and enhancement of these mechanisms to better serve the interests of both the government and taxpayers.

### 3.2.6 Examine the potential for tax policy improvements in Malawi

The study seeks to provide insights into the areas where policy improvements or interventions may be needed to facilitate income tax compliance among SMEs in Malawi. It aims to offer practical recommendations to policymakers and tax authorities based on the perceptions and experiences of SMEs.

Examining the potential for tax policy improvements in Malawi is a critical endeavor for the government, policymakers, and the country's economic development. Effective tax policies play a pivotal role in revenue collection, economic growth, and social development. Here, we'll explore the potential areas for tax policy improvements in Malawi:

Progressive taxation: Malawi can explore the possibility of implementing a more progressive tax system that places a higher tax burden on individuals and businesses with higher incomes. This can help redistribute wealth and reduce income inequality.

Simplified tax code: Simplifying tax regulations and procedures can make it easier for individuals and businesses to understand and comply with tax laws. Reducing complexity can also lead to improved tax collection and fewer compliance issues.

Tax incentives and exemptions review: Regularly reviewing and evaluating existing tax incentives and exemptions can help identify which are effective and which may need adjustment or elimination. This can ensure that the government is not unnecessarily forgoing revenue.

Small business support: Developing tax policies that provide support and incentives to small and medium-sized enterprises (SMEs) can stimulate economic growth. This might include lower tax rates or deductions for SMEs to encourage entrepreneurship and job creation.

Efficient use of tax revenue: Ensuring that tax revenue is efficiently and transparently utilized for public services is essential. Improving accountability and governance can build public trust and support for tax policies.

Environmental taxes: Malawi can consider implementing taxes and incentives that promote environmental sustainability. This may include taxes on polluting activities or tax breaks for green investments.

Property tax reform: Reforming property tax regulations and assessment processes can help increase revenue collection. Accurate property assessments and a fair valuation system are essential.

Digital economy taxation: Given the rise of the digital economy, updating tax policies to address e-commerce, online services, and remote working can help capture revenue from these sectors effectively.

Tax compliance measures: Implementing measures to improve tax compliance, such as electronic filing and payment systems, can streamline the tax collection process and reduce tax evasion.

Anti-avoidance measures: Strengthening anti-avoidance measures and transfer pricing rules can help prevent multinational corporations from shifting profits to low-tax jurisdictions.

Harmonization with regional and global norms: Aligning tax policies with regional and global norms and agreements can facilitate trade and investment while ensuring that tax leakage is minimized.

Social safety nets: Tax policies can be used to fund social safety nets for vulnerable populations. This includes designing tax measures to ensure that the burden does not disproportionately fall on low-income earners.

Public participation: Involving the public in the tax policy-making process can help ensure that policies align with their interests and values. Public consultations and feedback mechanisms can provide valuable insights.

Data collection and analysis: Enhancing data collection and analysis capabilities can help tax authorities identify tax evasion and inform policy adjustments.

Training and capacity building: Investing in the training and capacity building of tax officials can improve tax administration and enforcement.

Long term planning: Developing a comprehensive, long-term tax policy plan that considers the country's economic and social goals is essential. This can provide stability and predictability for taxpayers and investors.

In conclusion, improving tax policies in Malawi can have a significant impact on the country's economic growth, revenue collection, and social development. These improvements should be guided by the principles of fairness, simplicity, and efficiency, and should be regularly reviewed and adjusted to address changing economic conditions and societal needs. Collaboration between the government, tax authorities, and stakeholders is crucial in this process to ensure that tax policies align with the country's long-term goals and promote sustainable development

### 3.2.7 Contribute to existing knowledge base

Ultimately, this research aspires to contribute to the existing body of knowledge on the nexus between income tax compliance and SME financial performance, with a specific focus on the Malawian context. It aims to enhance our understanding of the challenges and opportunities faced by SMEs in complying with income tax regulations and how this compliance relates to their financial well-being.

By achieving these objectives, this research aims to provide valuable insights for SMEs, tax authorities, policymakers, and other stakeholders in Malawi. It seeks to shed light on the intricate dynamics of income tax compliance and its repercussions on the financial health of SMEs, thereby offering guidance for more effective tax policies, support mechanisms, and business strategies in the pursuit of sustainable economic growth and development in Malawi.

## 3.3 Research methodology

Research methodology can be defined as "the path through which researchers need to conduct their research" (Grover 2015, p. 1). It shows the path "through which researchers formulate their problem and objective, analyze and present their results from the data obtained during the study period" (Grover 2015, p. 1). This write-up on research approach and design shows how the research outcome at the end will be achieved in line with meeting the objectives of this study. As a result, the chapter discusses the research methods used in this study process; it outlines the research strategy, research design, research methodology, data sources such as primary data source, population consideration and sample size determinants, data collection methods like primary data collection, data collection through questionnaires, data collection tools, pre-test, method of data analysis to be used such as qualitative data analysis, data analysis software to be used, the reliability and validity analysis of data, identification and description of key variables of interest (dependent, independent, moderating and intervening).

The study follows the quantitative method approach because it measures SME perceptions regarding the level of income tax compliance on a five point likert scale basis, which is quantitative in nature, as well as if a relationship exists between the following two variables: level of income tax compliance on one hand and the impact such perceived level has on financial performance (financial performance being measured in terms of perceptions of level of sales and related profitability of SMEs captured on a 5 point likert scale) on the other hand. Both variables are also measured in terms of perceptions captured on a three to five point likert scale basis, which is quantitative in nature too.

Due to availability of mobile devices as well as access to internet in the country, the study was conducted online through an electronic survey instrument which was used as a data collection tool - to obtain data from respondents online. The questionnaire survey was carefully designed in order to capture all important elements of the study.

Data was collected from a random sample of SMEs of 413 in in all the four cities of Malawi, namely, Lilongwe, Blantyre, Mzuzu and Zomba. The cities were selected because of the high concentration of SMEs in cities as well as their strategic location. The cities are located throughout the country. Random sampling was choses in order to give all SME entities an equal chance of being selected for testing. A Taro Yamane Formula (Yamane, 1973) computed representative sample of 413 SMEs was selected for testing. Each selected SME was hand-delivered a pre-printed questionnaires to complete, from a total population of 37,581 profit-oriented SMEs in Malawi. This was after satisfying all ethical considerations in line with the schools Research Ethics Committee guidelines.

To summarize this section, in order to satisfy the objectives of this study, a quantitative research method approach was suggested. The study made use of the quantitative strategy for the reasons discussed below.

### 3.4 Research Approach and Design

According to Grover (2015), the research design is intended to provide an “appropriate framework for a study” (p. 1). A significant resolution in research design process is how to choose the research approach because it governs how applicable data for the research study will be gotten; According to Grover (2015), the research design procedure encompasses several interconnected choices.

As noted above, the study employs a quantitative research method. This study follows the quantitative method approach since the study instrument obtains SME quantitative data in form of SME perceptions regarding the impact of income tax compliance. The research instrument also measures the perceptions of the level of income tax compliance, which is quantitative in nature. The study also measures if a relationship exists between the following two variables of interest: current level of income and profitability tax compliance on one hand and the impact such perceived level of income tax compliance has on financial performance (financial performance being measured in terms of perceptions of sales and profitability levels of related SMEs) on the other hand. Both variables are measured quantitatively too, hence the choice of the quantitative method approach.

To achieve this, a constructivist approach was employed. A constructivist approach acknowledges that reality is constructed by individuals based on their experiences and interpretations. In the context of this research, SME owners and managers constructed their perceptions and experiences of income tax compliance and its impact on financial performance.

On this study, a questionnaire with well-structured questions was used as the main research tool to gather data. The questionnaire was divided into two sections: Section A and B. The first section (Section A) of the questionnaire tool consisted of a sequence of well-structured questions relating to general characteristics of the entity, like gender, age, level of education, number of years the subject has been in existence, seniority at work, nature of entity and size of entity. The second section of the tool (section B) consisted of questions relating to tax compliance level, general tax deterrence instruments, tax morale and impact of tax compliance on financial performance of the entities under study. The research was an assessment of impact of income tax compliance on financial performance of SMEs in Malawi. The research was carried out in all the four cities of Malawi.

The reasons for carrying out this study in all the cities of Malawi was because the high concentration of SMEs in the cities, as opposed to the rural areas.

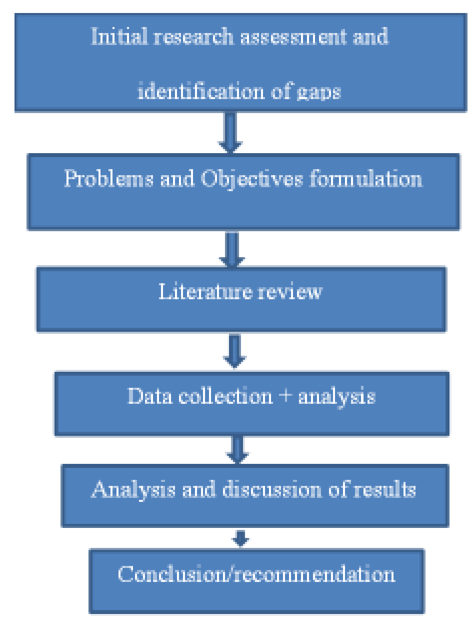
In line with the research objectives and related questions, it was best to respond to them by way of perceptions and facts. This is because it is difficult to get up to date figures about actual sales and profitability in this part of the world. These perceptions and facts were turned into numerical numbers on a 3-to-5-point likert scale basis, where, for example, 1 represented strongly disagree, 2 agree, 3 neither agree nor disagree, 4agree and 5 strongly agree.

In finding out the level of income tax compliance of an SME, the respondents were requested to give their answers on a three-point likert scale, where a 1 was taken as non-compliant, 2 as Partially compliant while 3 was taken as fully compliant. In finding out the impact of the level of compliance as observed above on financial performance (on turnover as well as on profitability), however, the scale parameters increased to five, where a 1 was designated as strongly negative, 2 as negative, 3 as neutral, 4 as positive and 5 as strongly positive".

All sampled SMEs were subjected to this type of scaled questions so as to be able to obtain responses in a uniform manner, amongst SMEs which were of varying sizes and merchandize. Such collected data resulted into data which was keyed into Statistical Package for Data Science (STATA) and analyzed using simple graphs and cross tabulations into informed results. This is unlike in a situation where the researcher attempts to obtain the actual sales figures and actual profitability figures because it is not only difficult to obtain up to-date figures in this part of the world, but the SMEs are at varying levels of sizes, and they also deal in different merchandize. The research design and flow process are depicted in Figure 3.2 below.

**Figure 3.1:**

*Research design and flow process*



## 3.5 Variables in this Quantitative Analysis

According to Gunasekele (2012), in many disciplines, the quantitative research paradigm was the main research paradigm throughout the 19th century era. This observation was earlier on observed by Leech, and Onwuegbuzie (2007), who stated that the quantitative research was considered as the only investigative methodology because it was the first research paradigm that incorporated "ontological, epistemological, axiological, rhetorical, and methodological assumptions and principles". After the 19$^{th}$ century, some researchers did not accept the conventions of quantitative paradigm and principles (Gunasekele 2012). They therefore initiated the quantitative research paradigm.

Below are detailed quantitative research variables that were considered in relation to the research topic: Assessing Perceptions of Income Tax Compliance Impact on SMEs' Financial Performance in Malawi (Year Ended 31st December 2022):

### 3.5.1 Income tax compliance perceptions

Awareness of tax obligations: Explored SMEs' awareness of their income tax obligations, including knowledge of tax laws and regulations applicable in Malawi during the study period.

Understanding tax procedures: Investigate SMEs awareness of their income tax obligations, including knowledge of tax laws and regulations applicable in Malawi during the study period.

Challenges in compliance: Identify the challenges faced by SMEs in meeting income tax compliance requirements, such as complex tax forms, record-keeping, and resource constraints.

### 3.5.2 Financial performance perceptions

Sales and profitability: Assess how SMEs perceived their sales, profitability and financial stability during the study period. The study identified financial performance of SME entities in terms of perceptions of level of sales and level of profitability as the variables of utmost interest. This variable of financial performance is considered to benefit more and to a greater extent depends on good compliance with income tax principles. It is therefore theorized that financial performance is dependent on another variable, income tax compliance, on the other hand. Income tax compliance is independent of financial performance.

### 3.5.3 Tax compliance behavior

Tax planning: Examine whether SMEs engage in tax planning strategies to optimize their tax liabilities.
Accuracy of tax payments: Explore the accuracy of SMEs tax payments in relating to their tax liabilities.
Timeliness of tax payments: Explore the accuracy of SMEs tax payments in relation to their tax liabilities.

### 3.5.4 Tax complexity factors

Complexity of tax regulations: Assess SMEs' perceptions of the complexity and clarity of tax laws and regulations during the study period.
Administrative burdens: Explore the administrative burdens associated with income tax compliance, including the complexity of tax forms and documentation.
Tax advisory services: Investigate the use of tax advisory services and the extent to which they help SMEs navigate tax complexity.

### 3.5.5 Tax morale and intrinsic motivations

Tax morale: Evaluate SMEs' tax morale, which reflects their intrinsic motivation to comply with tax obligations due to factors like trust in government, perceptions of tax fairness, and societal responsibility.
Motivation for compliance: Investigate the underlying motivations that drive SMEs to comply with income tax regulations, such as a sense of duty or trust in the fairness of the tax system.

### 3.5.6 Institutional factors

Perceptions of tax authorities: Explore SMEs' perceptions of tax authorities, including their attitudes toward tax enforcement and interactions with tax officials.
Awareness of tax support services: Assess SMEs awareness of and engagement with government-provided tax support services, such as tax education and advisory services.

### 3.5.7 Socio economic and demographic factors

Industry type: Investigate whether perceptions of income tax compliance and financial performance vary by industry.
Size of SME: Explore how the size of SMEs, in terms of employees or annual revenue, may impact their perceptions.
Geographic locations: Consider regional variations within Malawi and how location may influence compliance perceptions.
These variables collectively provide a comprehensive framework for conducting quantitative research on the topic. They enable a thorough exploration of SMEs' perceptions, attitudes, and experiences related to income tax compliance and its impact on their financial performance in the specific context of Malawi in the year ended 31st December 2022. The Research will make use of interviews, thematic analysis to delve into these variables, yielding valuable insights into the intricate relationship between tax compliance and SME financial well-being.

## 3.6 Sources of quantitative data

According to the University of South Carolina website http://libguides.usc.edu, the following are the common sources of quantitative data: “Surveys, which can be conducted online, or by phone or in person by the interviewer. Same questions will be asked in the same way to a large number of people; Observations, which may comprise counting the number of times that a particular phenomenon occurs, such as how often a particular word is used in interviews, or coding observational data to translate it into numbers; and Secondary data”, which is readily available information in organizations and companies, such as budgets and accounts.

The research made use of primary data from the taxpayers. Data collection used a structured questionnaire survey. The questionnaire was distributed by hand by research assistants, straight to randomly selected SMEs and completed online to a centrally located server within a space of two weeks, in the month of July 2023.

### 3.6.1 How quantitative data was obtained and analyzed

A number of statistical techniques can be said to be available to analyze data which is obtained by way of perceptions on a likert scale basis and which is therefore quantitative in nature. From simple graphs drawn in Microsoft excel to tests of relationship or association between two or more variables, a statistical package like Statistical Software for Social Sciences (STATA) can be used.

This research study used STATA as the main data analysis tool. Data gathered online was amended and modified where appropriate, then explored using a statistical platform, the statistical package for social scientists (STATA). Some modest tabulations and cross tabulations were done to show the degree of strength among the two variables of most interest: perceived level of income tax compliance of SMEs on one hand and impact of income tax compliance on perceived financial performance of SMEs on the other hand. Some simple graphs were done too including some graphical representations of means, medians and averages were also presented to disclose the associations established from evaluated data.

### 3.6.2 The questionnaire

The research data was collected online using the questionnaire. A questionnaire has been defined "as a pre-formulated written set of questions to which respondents record their answers, usually within rather closely defined alternatives" (Debois 2019). One major advantage of Questionnaires is that they can be easily sent to many respondents by hand, post and email and saves the researcher time and money (Sekaran 2003; Debois 2019). This can be said to be so true, especially in this part of the world where use of internet is very limited, but research assistants can be used to collect data online, to a central server. Leedy and Ormrod (2001), identifies one main advantage of the questionnaire as being the fact that people are generally more honest while completing the questionnaires regarding contentious matters in particular due to the point that, as is the case with this specific study, their replies are unidentified. Leedy and Ormrod (2001) further observes that Questionnaires can be a useful and effective means of data gathering especially when the researcher has a clear idea of what is needed and how to measure or quantify the variables of interest.  However, some disadvantages of the questionnaire have been identified.

According to Debois (2019), some people who get questionnaires do not return them and those who do might not be representative of the originally selected sample.

The questionnaire in this study consisted of close ended matrix and related questions. A 3-to-5-point Likert scale was used with matrix questions.

A Likert scale is typically a 5 or 7-point scale, which is employed to enable a respondent to "express how much they agree or disagree with a particular statement" (McLeod 2019, p. 17). A likert scale embraces that the strength or intensity of an attitude is linear, for example, on a range from strongly disagree to strongly agree, and is of the notion that attitudes are measurable (Brown 2010; McLeod 2019). As an example, each of the five or seven replies could have a numerical value to test or measure the aspect under examination.

Where a 5-point Likert scale was used with matrix questions, 1 represented "strongly disagree" 2 represented "Disagree" 3 represented "Neutral" 4 represented "Agree" and 5 represented "strongly agree". Where a 3-point Likert scale was used with matrix questions, 1 represented "Disagree" 2 represented "Neutral" and 3 represented "Agree".

The questionnaire was divided into sections A and B. Section A comprised of personal and entity characteristics. Section B was divided into 4 subsections, namely, "tax compliance level, general tax deterrence instruments, tax morale and impact of income tax compliance on sales and profitability". Each of these subsections had a few questions carefully formulated to capture needed perceptions.

Tax morale comprised of a 5 point likert scale questions surrounding areas including level of trust, pride and satisfaction in the Government, apparent level of respect/regard commanded by the respondent in society, whether income tax evasion is considered widespread, whether there is a feeling that the Malawi tax system puts a heavier tax burden on SMEs in comparison to large entities and whether the tax payer is aware that a tax called Value Added Tax (VAT) is usually paid whenever products are bought in supermarkets.

The study used mostly simple random sampling as the types of trade are wide-ranging and scattered. Besides, the simple random sampling method meant that each participant had an equal chance of being selected, thereby assisting this study to increase the reliability of the research outcome and its decision. Part of the criteria for sample selection criteria included a permanent place of business, meaning, mobile SMEs or individual street vendors were excluded; nature of trade/industry, i.e., whether it is a service, manufacturing, retail, construction etc., nature of resource used at work, and location within Malawi.

The study specifically excluded nonprofit oriented entities like Government departments and other related non-governmental organizations.

In order to protect the confidentiality of the respondents, no name of the respondent was required. Each questionnaire contained a serial number for the purpose of tracking responses.

## 3.7 Population and sample size

### 3.7.1 Research population

As noted above in this chapter, the economic industry in Malawi is made up of practically Micro, small and medium sized entities (MSMEs). As per the world bank report of May, 2022, the 2019 Finscope Micro, Small and Medium Enterprises (MSMEs) estimated that there were about 1.6 million MSMEs in the Malawi which employed about 1.8 million people in total. This report established that approximately 74% (1,184,000) of the enterprises were micro enterprises, 23% (368,000) were small enterprises and only 3% (48,000) were considered as medium enterprises. The report estimates that the Micro, Small and Medium Enterprise sector "contributes about 40% of gross domestic product (GDP) and 24% of employment, and that about 21% of the country's adult population derives their livelihood from the sector". This level of contribution cannot be said to be small.

The 74% micro enterprises, characterized by mobile vending and lack of a permanent trading location, are not expected to be registered for income tax with the Malawi Revenue Authority because they are subjected to local daily market fees (a form of daily tax) by the local Council they are operating from. Hence these are excluded from the study and the concentration on this study is on small and medium enterprises (SMEs) only, which were approximated by the 2019 Finscope Micro, Small and Medium Enterprises (MSMEs) survey to be at a total of 416,000 in Malawi.

### 3.7.2 Study sample size

A representative Taro Yamane (Yamane, 1973) computed sample size of 413 SMEs was selected, from a population of 416,000 profit-oriented SMEs in Malawi.

Simple random sampling was engaged to pick a representative SME industry in Malawi. Random sampling made sure that each SME had the same likelihood of being selected as well as the probability of receiving a reply.

### 3.7.3 Source of data and sampling timeline

This study made use of primary data from the taxpayers relating to the period 1st January 2022 to 31st December 2022. Data collection used online structured questionnaire. The questionnaire was distributed electronically to randomly selected SMEs and responses were received back from interviewees within two weeks of distributing the questionnaire.

### 3.7.4 The research instrument

The research instrument was in form of an online questionnaire, comprising of close ended matrix and related questions. A 3-to-5-point Likert scale was used with matrix questions, with 1 representing "strongly disagree", 2 "disagree", 3 "average", 4 "agree" and 5 "strongly agree" where a 5-point likert scale was used and 1 representing "Disagree" 2 "neutral" and 3 "Agree" where a three-point scale was used.

In order to protect the confidentiality of the respondents, no name of the respondent was required.

### 3.7.5 Basis of sample size

The basis of the sample size was embraced from Taro Yamane (Yamane, 1973) "sample size formula". The Taro Yamane (Yamane, 1973) sample size formula allows a "researcher to compute an appropriate sample size at a given preferred level of precision, desired level of confidence, and the likely proportion of the attribute present in the population. According to Taro Yamane (Yamane, 1973) formula is:

$$n = \quad N/(1 + Ne\text{^}2)$$

Where $n$ = sample size, $N$ = population size which contains the attribute we are concerned with (in this case, all SMEs in Malawi) and $e$ = error (0.05) (reliability level 95%). The Taro Yamane (Yamane, 1973) formula always sets reliability level at 95%.

In this study, total population (N) of the SME industry in Malawi is estimated at 416,000. The level of precision of 0.05% is adopted by the Taro Yamane formula (95% confidence level). This gives a sample size (n) of 413 as computed below:

$n =$ N/(1 + N$e$^2) = 416,000/(1+416000(0.05*0.05)) = 413

Hence a randomized sample of 413 SME enterprises in the target population of SMEs in Malawi was sufficient to give the 95% confidence level needed.

## 3.9 Data Collection and Analysis

### 3.9.1 Data collection instrument

This research study employed an online questionnaire as a key means of data collection. The choice of this method as the key means of data collection depended on a number of factors, the most important of which was the precision and importance of the information the questionnaire is capable of yielding and practical thoughts like the ease of administration of an online questionnaire.

## 3.10 Pilot Testing, reliability and validity

### 3.10.1 Pilot testing

A pilot test for the questionnaire tool was carried out to validate the questionnaire tool content. A pilot study can be defined as a "small study to test research protocols, data collection instruments, sample recruitment strategies, and other research techniques in preparation for a larger study (Mageto, Luke & Heyns 2019; Fraser, Fahlman, Arscott and Guillot 2018). A pilot study is said to be one of the important stages in a research project and is conducted to identify potential problem areas and deficiencies in the research instruments and protocol prior to implementation during the full study (Mageto, Luke & Heyns 2019). A pilot study can also help members of the research team become familiar with the procedures in the protocol, and can help them decide between two competing study methods, such as using interviews rather than a self-administered questionnaire" (Mageto, Luke & Heyns 2019).

A pilot study was done on a targeted proportionate random sample size of 40 SMEs.

According to Mageto, Luke & Heyns (2019), pilot trials are often small versions of the main trial, undertaken to test trial methods and procedures. The overall aim of a pilot study was to demonstrate that a future study could be undertaken.

The sample size for the purpose of piloting was based on approximately 10% of computed overall sample size of 413 SME enterprises, which resulted into a pilot sample size of 40.

Feed-back obtained from piloted respondents resulted into appropriate modification to the questionnaire instrument, including deletion of some questions/statements, as a result, content validity, (in which the questions are answered to the target without excluding important points), internal validity (in which the questions raised answer the outcomes of researchers' target), and external validity" (in which the result can generalize to all the population from the survey sample population) were tested.

### 3.10.2 Reliability of the research data

Reliability can be defined as "the extent to which measurements are repeatable –when different persons perform the measurements, on different occasions, under different conditions, with supposedly alternative instruments which measure the same thing" (Dorst; http://psc.dss.ucdavis.edu). Kimberlin and Winterstein (2008) postulated that reliability estimations are employed to appraise the stability of measures taken at different times to the same individuals (test–retest reliability) or the sameness of sets of items from the same test (internal consistency). Reliability coefficients range from 0.00 to 1.00, with higher coefficients indicating higher levels of reliability" (Kimberlin and Winterstein 2008).

### 3.10.3 Stability or test-retest stability

According to Drost (2016), test-retest reliability refers to temporal stability of a test from one measurement session to another. The practice is to give the test to a group of respondents and then give the very same test to the same respondents at a later date. The correlation between the scores of the above two tests which are given at two different times defines its test-retest reliability. Drost (2016) identifies several limitations with the test-retest reliability technique. For example, when the time between the first and second test is very short, interviewees might recall what was on the first test and will give the same answers on the second test as well. The second test will be affected by memory. Alternatively, when the time between the two tests is very long, maturation/evolution happens. Maturation is defined by Dross (2016) as referring to changes in the subject factors or respondents that take place over time and cause a change from the initial measurements to the later measurements. According to Dross (2016), during the time between the two tests, the respondents could have been exposed to things which changed their sentiments, thoughts about the behavior under study.

### 3.10.4 Internal consistency

Internal consistency is said to be "concerned with the reliability of the test components (Drost 2016), internal consistency is about consistency/reliability/uniformity/stability of the instrument and enquires how well a set of items measures a particular behavior or characteristic" within the test. For a test to be "internally consistent, estimates of reliability are based on the average inter-correlations among all the single items within a test.

The most popular method of testing for internal consistency in the social sciences is coefficient alpha (Drost, E.). According to Drost (2016), coefficient alpha was popularized by Cronbach (1951), who acknowledged its helpfulness. Because of this, it is referred to as Cronbach's alpha. Coefficients of internal consistency increase as the number of items goes up, to a certain point. For instance, a 5-item test might correlate .40 with true scores, and a 12-item test might correlate .80 with true scores. Consequently, a single item would be expected to have a low correlation with true scores. Which means, with true scores, if coefficient alpha is very low, then, probably the test is too short or the items have very little in common. Before testing the hypothesis, the researcher first tested the validity and reliability of the questionnaire. Reliability test used is Cronbach Alpha. Cronbach Alpha is a reliability coefficient that indicates how well items in a measuring instrument are positively correlated with others. A measuring instrument is said to be reliable if Cronbach Alpha > 0.6. Reliability test results obtained by Cronbach Alpha coefficient value greater than 0.6 so that the measuring tool used is reliable".

In this study of a targeted randomly selected pilot sample of 40, Cronbach's alpha reliability analysis for internal consistency of the questionnaire instrument of 32 questions/statements grouped into four categories was found to be 0.94. A reliability coefficient of 0.70 and higher is reflected as adequate in most research circumstances Drost (2016). Detailed results for this test are given in the data analysis chapter.

### 3.10.5 Validity of data

Validity can be defined as "the credibility or believability of the research (Kimberlin and Winterstein 2008, p. 3). Kimberlin, et al (2008) observes that Validity necessitates that an implement is reliable. Three types of validity are identified: "Construct, content and criterion related" (Kimberlin and Winterstein 2008, p. 3).

#### 3.10.5.1 Construct Validity

Construct validity describes "how well an experiment measures up to its claims (Shuttleworth). This type of validity is founded on the experience of the build-up of evidence from various studies using a precise and definite measuring gadget (Kimberlin and Winterstein 2008 p. 4). A test intended to measure depression must only measure that specific construct, not any other closely related areas such as anxiety or stress. Assessment of construct validity requires probing the relationship of the measure being evaluated with variables known to be related or theoretically related to the construct measured by the instrument. As Kimberlin and Winterstein (2008) observes, a measure of quality of life would be expected to result in lower scores for chronically ill patients than for healthy college students.

In this study, the researcher made sure when developing the research instrument that doubts were removed by means of suitable questionnaire wording and thoughtfulness so as to increase clearness and over-all rightness. Over and above, the questionnaire was subjected to the research supervisor who has expertise in this area, to make sure that the questionnaire, which is the measuring instrument, may be reflected as valid on the face of it. The researcher was guided by mostly published literature originating from within and outside the country, related to impact of tax compliance on financial performance of SMEs, before the measuring instrument was developed. As a result, the measuring instrument revolves around tax compliance determinants according to the tax compliance theories and related extant literature. Over and above this, a pilot test was carried out.

3.10.5.2 Content validity (similar to sampling validity)

Sampling validity makes sure that the area of coverage of the measure within the research area is big enough (https//research-methodology.net). No measure is able to cover all the items and elements within the phenomenon, therefore, important items and elements are selected using a specific pattern of sampling method depending on aims and objectives of the study. This type of validity addresses how sound the items developed to operationalize a construct provide an adequate and representative sample of all the items that might measure the construct of interest (Kimberlin and Winterstein 2008). In order to test content validity, a pilot test was carried out on 40 SMEs. The sample size for the purpose of piloting was based on approximately 10% of computed sample size of 413. The main aim of carrying out a pilot test for the questionnaire research tool was to validate the questionnaire content. Feed-back obtained from piloted respondents resulted into appropriate modification to the questionnaire instrument. As a result, content validity, in which the questions are answered to the target without excluding important points, internal validity in which the questions raised answer the outcomes of researchers' target, and external validity in which the result can generalize to all the population from the survey sample population have been tested.

3.10.5.3 Criterion-related validity

According to https//research-methodology, this type of validity "involves comparison of test results with the outcome. It correlates results of assessment with another criterion of assessment". Kimberlin and Winterstein (2008) have explained this phenomenon as follows:

> This type of validity provides evidence about how well scores on the new measure correlate with other measures of the same construct or very similar underlying constructs that theoretically should be related. It is crucial that these criterion measures are valid themselves.

### 3.11 Operational definition of variable

The purpose of this research study was to "assess perceptions of the impact of income tax compliance on financial performance of SME enterprises in Malawi, for the year ended 31$^{st}$ December 2022. This study found out if SMEs in Malawi, pay fully, partially or not at all, income tax charged on them by the Malawi Revenue Authority. The other aim of this study was to evaluate the perceived effect, such measure of income tax compliance has on financial performance of these SME's. Financial performance was measured by way of respondent's perceptions of level of sales and profitability, whether in their opinion they believe that sales and profitability of their SMEs were high or low, using a three to five point likert scale.
The industry in Malawi is mostly made up of SMEs. A Small and Medium Size Enterprise (SME) in Malawi is taken as an entity with at-least two of the following features: its share capital investment is between US$2,000 and US$100,000: it hires between 1 - 499 employees and makes a turnover of up to US$1,000,000 (Kayanula et al 2000)".

### 3.12 Study Procedures and Ethical Assurances

This study received approval from the Unicaf University's Research Ethics Committee (UREC) prior to data collection. The participants were first informed verbally and in writing about the nature and demands of the study. The participants gave their informed consent in writing and volunteered to participate in the study with the approval of the Unicaf University's Research Ethics Committee in accordance with the Helsinki Declaration.

Data collection to test all of the two main income tax compliance theories as described in detail under literature review section, namely, the general tax economic deterrence (tax fines, penalties and tax amnesty) and the social psychology deterrence (trust in Government, national pride, importance of Government) in identification of the impact of income tax compliance on financial performance of a sample of enterprises in Malawi was done through a 42-item questionnaire interview. The questionnaire was divided into sections A and B.

Section A comprised of personnel and entity characteristics like age, gender, level of education, number of years the entity has been in operation, class of industry, current position of the respondent, and entity size in terms of number of employees.

Section B was further divided into 4 subsections, namely, tax compliance level, general tax deterrence instruments, tax morale and impact of income tax compliance on sales and profitability.

Tax compliance level comprised of types of income tax complied with, the last time the entity computed tax, whether income tax obligation was computed accurately, whether an income tax return was completed, ease of completion of income tax return, whether the return was submitted to MRA, whether income tax obligation was paid in time, whether income tax obligation was paid accurately and whether all income tax liabilities are paid.

General tax deterrence instruments comprised of mostly 5 likert scale questions on level of fairness and ease of following the Malawi tax law, whether other tax payers find it wrong not to pay their income tax obligation, whether other tax payers find it easy to evade income tax, probable ease with which the Revenue Authority discovers non-tax payers, whether it is justifiable not to pay correct income tax if a chance availed itself to do so, whether the Revenue Authority provides good tax payer education, whether there are incentives from the Revenue Authority for being tax compliant and whether the tax payers had heard of the tax amnesty window which opened in April 2020 and was to close on 31 October 2020 and whether the respondents had taken advantage of the tax amnesty window to clear any possible outstanding income tax liabilities.

Tax morale comprised of 5 point likert scale questions surrounding areas including level of trust, pride and satisfaction in the Government, apparent level of respect/regard commanded by the respondent in society, whether income tax evasion is considered widespread, whether there is a feeling that the Malawi tax system puts a heavier tax burden on SMEs in comparison to large entities and whether the tax payer is aware that a tax called Value Added Tax (VAT) is usually paid whenever products are bought in supermarkets.

Impact of income tax compliance on sales and profitability comprised of 5 point likert scale consideration on whether current level of income tax compliance resulted in overall improved sales or not and whether the respondents believed that their entity's sales and profitability were high.

In order to safeguard the privacy of the respondents, no name of the respondent was required on the questionnaire and the participants were assured in writing that data generated was purely for academic purposes only and would be treated with the utmost confidentiality".

Each questionnaire contained a serial number only for the purpose of tracking responses.

The participants had the right to withdraw at any stage (prior or post the completion) of the research without any consequences and without providing any explanation. In cases like these, data collected would be deleted. All data and information collected was coded and was not accessible to anyone outside this research. Data described and included in dissemination activities will only refer to coded information ensuring beyond the bounds of possibility participant identification.

### 3.13 Data collection and analysis

Consistent with Nkote and Tasubila (2013), data collection revolved around the two main income tax compliance theories as described in detail under literature review section, namely, the general tax economic deterrence (tax fines, penalties and tax amnesty) and the social psychology deterrence (trust in Government, national pride, importance of Government). This was in identification of the impact of income tax compliance on financial performance of a sample of enterprises in Malawi.

Data collection was done using a 42-item questionnaire interview. Questions were framed to tap responses from the two income tax theories.

The questionnaire documented the questions and respondents were required to give a response on a five-point likert scale. After reviewing a number of the item measures formerly employed by researchers to measure the theories of income tax compliance and impact of such income tax compliance, distinct element scales were planned to measure the concepts under study.

The element scales were carefully scrutinized, similarities noted were removed. The measurement scales were tested on a pilot basis by means of 30 SMEs, giving a 100% rate of reply.

Subsequent to the pilot study, element scales which were not clear had to be either rephrased or removed from the research instrument, the questionnaire.

All element scales attained a Cronbach alpha reliability coefficient of more than 0.7.

The final questionnaire included all the income tax compliance variables being studied on a five-point likert scale. The element scales were framed in such a way as to tap responses in relation to income tax level and the perceived impact such income tax compliance level has on the performance of the enterprises.

The respondents were asked to answer the set questions with all honesty, instead of simply choosing the sometimes socially desirable middle neutral position on the 5 point likert scale. This resolution arose from the observation of Garland (1991) that social desirability bias arises from respondent's desire to please the interviewer or appear helpful or not be seen to give what they perceive to be a socially unacceptable answer.

The questionnaire was divided into sections A and B. Section A comprised of personnel and entity characteristics like age, gender, level of education, number of years the entity has been in operation, class of industry, current position of the respondent, and entity size in terms of number of employees.

Section B was further divided into 4 subsections, namely, tax compliance level, general tax deterrence instruments, tax morale and impact of income tax compliance on sales and profitability.

Tax compliance level "comprised of types of income tax complied with, the last time the entity computed tax, whether income tax obligation was computed accurately, whether an income tax return was completed, ease of completion of income tax return, whether the return was submitted to MRA, whether income tax obligation was paid in time, whether income tax obligation was paid accurately and whether all income tax liabilities are paid. General tax deterrence instruments comprised of mostly 5 likert scale questions on level of fairness and ease of following the Malawi tax law, whether other tax payers find it wrong not to pay their income tax obligation, whether other tax payers find it easy to evade income tax, probable ease with which the Revenue Authority discovers non-tax payers, whether it is justifiable not to pay correct income tax if a chance availed itself to do so, whether the Revenue Authority provides good tax payer education, whether there are incentives from the Revenue Authority for being tax compliant and whether the tax payers had heard of the tax amnesty window which opened in April 2020 and was to close on 31 October 2020 and whether the respondents had taken advantage of the tax amnesty window" to clear any possible outstanding income tax liabilities.

Tax morale comprised of 5 point likert scale questions surrounding areas including "level of trust, pride and satisfaction in the Government, apparent level of respect/regard commanded by the respondent in society, whether income tax evasion is considered widespread, whether there is a feeling that the Malawi tax system puts a heavier tax burden on SMEs in comparison to large entities and whether the tax payer is aware that a tax called Value Added Tax" (VAT) is usually paid whenever products are bought in supermarkets.

Impact of income tax compliance on sales and profitability comprised of 5 point likert scale considerations on whether current level of income tax compliance resulted in overall improved sales or not and whether the respondents believed that their entity's sales and profitability were high.

### 3.14 Quantitative data analysis

Quantitative data obtained from surveys and interviews was analyzed using thematic analysis (Braun & Clarke, 2006). Transcripts were be coded, and recurring themes and patterns were identified. This quantitative analysis provides deeper insights into the perceptions and experiences of SMEs. Likert scale data was analyzed using STATA. The study employed descriptive statistics in the analysis of the likert scale data. The descriptive aspect provided the summaries such as percentages presented in cross-tabulations and bar graphs in order to describe the variables in the study. These statistical tests were carried out at 5% level of significance. This tool (STATA) was principally used to clarify the causal relationship between the two variables namely, level of income tax compliance on one hand and impact of tax compliance on financial performance of SMEs. P vales were computed and evaluated with the aim of determining the degree of association between the various levels and impact factors. Nine major tax compliance items which were tested in terms of the level of income tax compliance are the nature of income tax an SME is compliant with; the last time an SME computed its income tax; whether the SME computed its income tax obligation accurately the last time it did the computation; whether the SME completed an income tax return the last time it computed its income tax; whether an SME found it easy to complete an income tax return; whether income tax return was submitted ; whether the computed income tax" obligation was paid to the Malawi Revenue Authority and whether all tax obligations were paid.

### 3.15 Conclusion

The research methodology outlined in this section provides a comprehensive framework for investigating SMEs' perceptions of income tax compliance and their effects on financial performance in Malawi. This quantitative methods approach, combining mostly surveys and partially interviews, allows for a nuanced understanding of the research problem. Ethical considerations ensure the protection of participants' rights and data privacy. While limitations are acknowledged, the methodology is designed to provide valuable insights into this important aspect of SMEs' operations and challenges in Malawi.

This study made use of mostly primary data from the taxpayers relating to the period 1st January 2022 to 31st December 2022, as a source of data. Data collection online using structured questionnaire on a representative SME sample size of 413, out of a population of approximately 416,000 MSEs in Malawi. Sampling was done using random sampling technique, to make sure that all SMEs have an equal chance of being sampled.

This comprehensive research methodology provides a detailed overview of the approach, methods, and techniques used to investigate the research problem. Researchers can use this quantitative methodology as a blueprint for conducting the study on SMEs' perceptions of income tax compliance and its impact on financial performance in Malawi.

## Chapter 4: Discussion of Research Findings

### 4.1 Introduction

The study delves into a critical examination of the perceptions of income tax compliance among Small and Medium Enterprises (SMEs) in Malawi for the fiscal year ending on 31st December 2022 and its profound implications on their financial performance. Malawi, like many developing economies, heavily relies on the contributions of SMEs to its economic growth. Understanding the dynamics of income tax compliance within this sector is pivotal, as it not only influences government revenue collection but also impacts the financial health and sustainability of these enterprises. This research presents a comprehensive analysis of SMEs' attitudes and behaviors towards income tax obligations, shedding light on the myriad factors that affect compliance, and ultimately, how such compliance, or lack thereof, affects their financial performance. In a world increasingly driven by fiscal policy and entrepreneurship, this study seeks to provide valuable insights that can aid policymakers, business owners, and stakeholders in making informed decisions to bolster the SME sector and foster economic growth in Malawi

### 4.2 Purpose of the research

The main purpose of this research study was to assess the impact of perceptions of income tax compliance on the financial performance of Small and Medium Enterprises (SMEs) in Malawi, for the twelve-month period ended 31st December 2022. According to the 2013 Malawi Income Tax Act, all profit-oriented entities are to account for income tax, the tax charged on profits made by entities, on a yearly basis.

This study found out if income tax is complied with by SMEs in Blantyre, and if it is, whether it is complied with fully or partially or even not complied with at all. The study also evaluated the perceived effect, if any, on financial performance of SMEs such noted level of income tax compliance has. The financial performance of SMEs is measured by the perception of the levels of product and service sales and related profitability.

This study has followed the quantitative method approach as opposed to the qualitative method approach as it is a measures SME perceptions of level of compliance with income tax and it also measures perceptions of the relationship, if any, between the following two identified variables of interest: income tax compliance level on one hand and the impact such perceived compliance level has on the financial performance, by way of perceived level of sales and profitability, on the other hand.

### 4.3 Results of findings including frequency tables and graphical illustrations

The following section presents results relating to impact of perceived income tax compliance on financial performance of Small and Medium Enterprises (SMES) in Malawi. These were collected from a randomly selected survey questionnaire on 413 Small and Medium enterprises in Malawi, Malawi,

The presentation of the results is guided by the following: assessing the level of income tax compliance on SMEs in Malawi during the year ended 31st December 2022 and assessing the impact of assessed income tax compliance levels on the financial performance of SMEs in Malawi during the year ended 31st December 2022. Collected data was keyed in and analyzed in Statistical Software for Data Science (STATA) version 20. The results are summarized and presented in simple frequency tables, graphs and simple cross tabulations below, which subsequently assisted in the analysis, conclusions and recommendations regarding the research questions.

General demographic and sample characteristics are presented first, followed by level of tax compliance which is explained by the two tax compliance theories: general deterrence instruments and tax morale and, finally, the effect of perceived income tax compliance on sales and profitability of SMEs is presented.

### 4.4 Sample location

The research survey respondents were sampled from all the four cities of Malawi, namely, the capital city Lilongwe, Blantyre city, Mzuzu city and Zomba city. These cities have by far where the greatest concentration of SMEs in Malawi.
In total, a sample size of 413 was taken, out of which 205 respondents, representing 49.6% of the sample size, were from the capital city, Lilongwe, while 95, representing 23% of the sample size,

were from Blantyre city and 76, representing 18.4% of the sample size, came from Mzuzu city while the remaining 37, representing 8.96% of the sample size, were from Zomba city (table 1). Sample size selection from each city was inspired by the approximate ratio of SMEs in each city.

**Table 1**

*City where SME entity is located*

| Please indicate the city where the entity is located | Freq. | Percent | Cum. |
|---|---|---|---|
| Blantyre | 95 | 23.00 | 23.00 |
| Lilongwe | 205 | 49.64 | 72.64 |
| Zomba | 37 | 8.96 | 81.60 |
| Mzuzu | 76 | 18.40 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

## 4.5 Demographic and sample characteristics

The personnel and sample characteristics which were analyzed for the sample of respondents included gender, age, education level, number of years the entity has been in existence, number of years the person has worked for the organization, position in the entity, class of industry and size of entity in respect of number of employees. Frequency tables 4.4 to 4.8 below presents a summary of statistics of the above-mentioned demographic characteristics.

*Gender of respondents*

The research survey findings revealed that 57.14% of the respondents were males while 42.8% were females (see findings in Table 2). This clearly shows that males dominated the operations of SMEs in Malawi.

**Table 2**

*Gender of respondents*

| Please indicate the gender of the respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| Female | 177 | 42.86 | 42.86 |
| Male | 236 | 57.14 | 100.00 |

| Total | 413 | 100.00 | |
|---|---|---|---|

*Age of respondents*

The age categories of respondents of the study were analyzed in Table 4.5. According to the results, the majority of the respondents (61.2%) were aged below 40 years while 38.74% were aged above 40 years (table 3).

**Table 3**

*Age of respondents*

| Category of respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| Young (below 40 years of age) | 253 | 61.26 | 61.26 |
| Old (more than 40 years of age) | 160 | 38.74 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

*Level of education*

The study analyzed the academic qualifications of respondents who filled the questionnaire survey on behalf of SMEs. According to the findings, 44.79% were secondary school graduates while 28% had college diplomas, 19.6% of the respondents were holders of undergraduate degrees and 1.1% of respondents had Masters Degrees. The study also revealed that 0.24% of respondents (one respondent) had a Doctorate degree while 6.05% of the respondents were primary school drop outs. The findings are illustrated in Table 4.

**Table 4**

*Level of education of respondent*

| Please indicate the level of education of respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| Primary | 25 | 6.05 | 6.05 |
| Secondary | 185 | 44.79 | 50.85 |
| Diploma | 116 | 28.09 | 78.93 |
| Undergraduate Degree | 81 | 19.61 | 98.55 |
| Master's Degree | 5 | 1.21 | 99.76 |
| Doctorate | 1 | 0.24 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

*Current position with the entity*

The study requested the respondents to select their current position in the organization amongst four specified categories of junior worker, senior staff, management team, and owner. According to the findings, 43.1% were the owners, 19.37% were management team members, 16.46% were senior staff while 20.82% were junior workers. The findings demonstrate that the majority of the respondents were higher than Junior members of staff, rendering credibility to the results of the survey. The findings are illustrated in Table 5 below

**Table 5**

*Current position of respondent*

| Which of the following best describes your current position | Freq. | Percent | Cum. |
|---|---|---|---|
| Junior worker | 86 | 20.82 | 20.82 |
| Senior staff | 68 | 16.46 | 37.29 |
| Management team member | 80 | 19.37 | 56.66 |
| Owner | 178 | 43.10 | 99.76 |
| Other Specify | 1 | 0.24 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

Class of industry

The study requested the respondents to select their class of industry amongst five specified common categories of service, manufacturing, retail and construction and real estate. The results as depicted in Table 4.10 found that, 41.4% were in the service industry, 45.76% were in retail industry, 8.9% were in construction and real estate (table 4.6).

**Table 6**

*Class of SME industry*

| Your company/entity falls under the following class of industry | Freq. | Percent | Cum. |
|---|---|---|---|
| Service | 171 | 41.40 | 41.40 |
| Manufacturing | 20 | 4.84 | 46.25 |
| Retail | 189 | 45.76 | 92.01 |
| Construction | 23 | 5.57 | 97.58 |
| Real estate | 10 | 2.42 | 100.00 |
| Total | 413 | 100.00 | |

*Registration status with Malawi Revenue Authority*

The study requested the respondents to state their registration status with Malawi Revenue Authority. The results as depicted in Table 4.9 found that 66.83% were registered for tax while 33.17 were not. Lilongwe city had the majority of SMEs registered with Malawi Revenue Authority at 142 out of total registered of 276 while Blantyre city came second and Zomba city came last with only 21 registered out of 276 (see table 4.10). In terms of industry type, service and retail had the most registrants at 116 and 113 out of 276 respectively. The relatively low levels of registration with the Malawi Revenue Authority need to be a matter of concern to the Authority itself (table 4.7)

**Table 7**

*Registration status with the Malawi Revenue Authority (MRA)*

| Is your entity registered for any tax with MRA? | Freq. | Percent | Cum. |
|---|---|---|---|
| Yes | 276 | 66.83 | 66.83 |
| No | 137 | 33.17 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

**Table 8**

*Registration status with MRA by city*

| Is your entity registered for any tax with MRA? | Please indicate the city where the firm is located | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| Yes | 65 | 142 | 21 | 48 | 276 |
| No | 30 | 63 | 16 | 28 | 137 |
| Total | 95 | 205 | 37 | 76 | 413 |
| | | | | | |

**Table 9**

*Registration status with MRA by class of SME industry*

| | Your company/entity falls under the following class of industry | | | | | |
|---|---|---|---|---|---|---|
| Is your entity registered for any tax with MRA? | Service | Manufacturing | Retail | Construction | Real estate | Total |
| Yes | 116 | 17 | 113 | 20 | 10 | 276 |
| No | 55 | 3 | 76 | 3 | 0 | 137 |
| Total | 171 | 20 | 189 | 23 | 10 | 413 |
| Pearson Chi2 = 16.45 Prob = 0.0025 | | | | | | |

*Knowledge of correct income tax rate*

The study requested the respondents to state whether they were aware of the correct income tax rate. The results as depicted in Table 4.12 found that 41.26% were aware of the correct income tax rate while 58.74 were not. The majority of those who were aware of the correct income tax rate were from Lilongwe city, followed by Blantyre city (table 4.13). Knowledge of correct income tax rate was also shown to increase with increasing education, rising from 40% with respondents with primary school education only to 45% with those holding diplomas and 62% with undergraduate degrees. 100% awareness was recorded with respondents with post graduate degrees (see table 4.14), clearly showing that as education level increases so does the knowledge of the correct income tax rate.

**Table 10**

*Knowledge of correct income/corporate tax rate*

| Do you know the correct income/corporate tax rate you are supposed to pay to MRA? | Freq. | Percent | Cum. |
|---|---|---|---|
| No | 242 | 58.74 | 58.74 |
| Yes | 170 | 41.26 | 100.00 |
| Total | 412 | 100.00 | |
| | | | |

**Table 11**

*SME location versus knowledge of correct income/corporate tax rate by city*

| Do you know the correct corporate tax rate you are supposed to pay? | Please indicate the city where the entity is located | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| No | 67 | 111 | 23 | 41 | 242 |
| Yes | 28 | 93 | 14 | 35 | 170 |
| Total | 95 | 204 | 37 | 76 | 412 |
| Pearson Chi2 = 7.92 Prob = 0.0477 | | | | | |

**Table 12**

*Level of education of respondent versus knowledge of correct income/corporate tax rate you are supposed to pay.*

| | Please indicate the level of education of respondent | | | | | | |
|---|---|---|---|---|---|---|---|
| Do you know the correct income/corporate tax rate you are supposed to pay? | Primary | Secondary | Diploma | Undergraduate Degree | Master's Degree | Doctorate | Total |
| No | 15 | 134 | 63 | 30 | 0 | 0 | 242 |
| Yes | 10 | 50 | 53 | 51 | 5 | 1 | 170 |
| Total | 25 | 184 | 116 | 81 | 5 | 1 | 412 |
| Pearson Chi2 = 40.30 Prob = 0.0000 | | | | | | | |

*Level of understanding of income tax regulations and compliance requirements*

The study requested the respondents to rate their level of understanding of income tax regulations and compliance requirements. The results as depicted in Table 4.15 found that a total of 80.47% were rated as having a good understanding of income tax regulations. Lilongwe and Blantyre cities registered the highest numbers of respondents with good knowledge of income tax regulations and compliance requirements (see table 4.16). Service and retail industries also had the highest numbers of respondents with good knowledge of income tax regulations. (See table 4.17)

**Table 13**

*Rating of respondent's level of understanding of income tax regulations and compliance requirements*

| How would you rate your level of understanding of income tax regulations and compliance requirements? | Freq. | Percent | Cum. |
|---|---|---|---|
| Very good understanding | 54 | 31.95 | 31.95 |
| Moderate understanding | 82 | 48.52 | 80.47 |
| I do not wish to comment | 5 | 2.96 | 83.43 |
| Very little knowledge | 26 | 15.38 | 98.82 |
| I know nothing about tax regulations | 2 | 1.18 | 100.00 |
| Total | 169 | 100.00 | |
| | | | |

**Table 14**

*City where SME is located versus rating of respondent's level of understanding of income tax regulations and compliance requirements*

| How would you rate your level of understanding of income tax regulations? | Please indicate the city where the entity is located | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| Very good understanding | 4 | 34 | 3 | 13 | 54 |
| Moderate understanding | 17 | 42 | 8 | 15 | 82 |
| I do not wish to comment | 2 | 2 | 1 | 0 | 5 |
| Very little knowledge | 5 | 14 | 2 | 5 | 26 |
| I know nothing about tax regulations | 0 | 0 | 0 | 2 | 2 |
| Total | 28 | 92 | 14 | 35 | 169 |
| Pearson Chi2 = 17.22 Prob = 0.1416 | | | | | |

**Table 15**

*Class of industry versus rating of respondent's level of understanding of income tax regulations and compliance requirements.*

| How would you rate your level of understanding of income tax regulations an | Your company/entity falls under the following class of industry | | | | | |
|---|---|---|---|---|---|---|
| | Service | Manufacturing | Retail | Construction | Real estate | Total |
| Very good understanding | 24 | 1 | 22 | 6 | 1 | 54 |
| Moderate understanding | 34 | 9 | 30 | 5 | 4 | 82 |
| I do not wish to comment | 2 | 1 | 0 | 2 | 0 | 5 |
| Very little knowledge | 12 | 2 | 10 | 2 | 0 | 26 |
| I know nothing about tax regulations | 1 | 0 | 1 | 0 | 0 | 2 |
| Total | 73 | 13 | 63 | 15 | 5 | 169 |

Pearson Chi2 = 15.90 Prob = 0.4597

*Status of filing of income tax return with Malawi Revenue Authority*

The study asked the respondents to state their status of filing income tax returns with Malawi Revenue Authority, whether they were up to date with submission of the income tax returns or not. The results as depicted in Table 4.18 disclosed that 52.43% had filed their return with MRA in time while 47.57% had not. Lilongwe and Blantyre cities registered the highest number of respondents who had filed the returns with MRA in time (table 4.19). Service and retail industries had the highest number of respondents Who had filed a return with MRA timely (see table 4.20). Filing level was observed to increase with increasing education level (table 4.21)

**Table 16**

*Status of filing of income tax return with Malawi Revenue Authority*

| Did your company/entity file the income/corporate tax return with Malawi Revenue Authority in time | Freq. | Percent | Cum. |
|---|---|---|---|
| No | 196 | 47.57 | 47.57 |
| Yes | 216 | 52.43 | 100.00 |
| Total | 412 | 100.00 | |

**Table 17**

*City where entity is located versus Status of filing of income tax return with Malawi Revenue Authority*

| Did your company/entity file the income/corporate tax return with MRA wit | Please indicate the city where the entity is located | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| No | 65 | 70 | 23 | 38 | 196 |

| | | | | | |
|---|---|---|---|---|---|
| Yes | 30 | 134 | 14 | 38 | 216 |
| Total | 95 | 204 | 37 | 76 | 412 |
| Pearson Chi2 = 34.27 Prob = 0.0000 | | | | | |

**Table 18**

*Class of industry versus status of filing of income tax return with Malawi Revenue Authority*

| Did your company/entity file the income/corporate tax return with MRA wit | Your company/entity falls under the following class of industry | | | | | |
|---|---|---|---|---|---|---|
| | Service | Manufacturing | Retail | Construction | Real estate | Total |
| No | 83 | 13 | 92 | 6 | 2 | 196 |
| Yes | 87 | 7 | 97 | 17 | 8 | 216 |
| Total | 170 | 20 | 189 | 23 | 10 | 412 |
| Pearson Chi2 = 9.94 Prob = 0.0415 | | | | | | |

**Table 19**

*Level of education of respondent versus Status of filing of income tax return with Malawi Revenue Authority*

| Did your company/entity file the income/corporate tax return with MRA within correct time frame? | A4. Please indicate the level of education of respondent | | | | | | |
|---|---|---|---|---|---|---|---|
| | Primary | Secondary | Diploma | Undergraduate Degree | Master's Degree | Doctorate | Total |
| No | 13 | 87 | 53 | 40 | 2 | 0 | 195 |
| Yes | 12 | 97 | 63 | 41 | 3 | 1 | 217 |
| Total | 25 | 184 | 116 | 81 | 5 | 1 | 412 |
| Pearson Chi2 = 1.69 Prob = 0.8900 | | | | | | | |

*Level of confidence regarding the accuracy and completeness of SMEs income*

The study asked the respondents to state their level of confidence in the accuracy and completeness of their income tax filings. The results as depicted in Table 4.22 disclosed that a total of 60.44% had confidence in the accuracy and completeness of their filings with MRA WHILE 15.78% did not.

**Table 20**

*Level of confidence regarding the accuracy and completeness of SMEs income tax filing*

| How confident are you in the accuracy | Freq. | Percent | Cum. |
|---|---|---|---|

| and completeness of your income tax filings? | | | |
|---|---|---|---|
| Very confident | 177 | 42.96 | 42.96 |
| Moderately confident | 72 | 17.48 | 60.44 |
| Unsure/No opinion | 98 | 23.79 | 84.22 |
| Somewhat confident | 32 | 7.77 | 91.99 |
| Not confident at all | 33 | 8.01 | 100.00 |
| Total | 412 | 100.00 | |
| | | | |

Whether authorities do income tax assessments within the expected *timeframe*

The study asked the respondents to state whether from their experience, MRA processed the income tax assessment within the expected time frame. A total of 43.2% agreed while 56.8% did not (table 4.23). The majority of those who agreed were from Lilongwe city, followed by Mzuzu city. Lilongwe and Blantyre cities had the majority of those who disagreed (table 23).

**Table 21**

*Whether authorities do income tax assessments within the expected timeframe*

| Do authorities do income tax assessments within the expected timeframe? | Freq. | Percent | Cum. |
|---|---|---|---|
| Yes | 178 | 43.20 | 43.20 |
| No | 234 | 56.80 | 100.00 |
| Total | 412 | 100.00 | |
| | | | |

**Level of satisfaction with the current support provided by tax authorities in understanding and fulfilling income tax obligations**

The study also asked the respondents to state their level of satisfaction with the current support provided by tax authorities in understanding and fulfilling income tax obligations. A total of 47.33% stated that they were satisfied with the current support provided by tax authorities in understanding and fulfilling income tax obligations while 30% stated that they were not (table 4.24). The majority of those who agreed were from Lilongwe city, followed by Blantyre city. Lilongwe and Blantyre cities had the majority of those who disagreed (table 25). The service and retail industries were most satisfied (table 26).

**Table 22**

*Level of satisfaction with the current support provided by tax authorities in understanding and fulfilling income tax obligations*

| How satisfied are you with the current support provided by tax authorities in understanding and fulfilling income tax obligations? |
|---|

| | Freq. | Percent | Cum. |
|---|---|---|---|
| Very satisfied | 97 | 23.540 | 23.540 |
| Moderately satisfied | 98 | 23.790 | 47.330 |
| Unsure/No opinion | 85 | 20.630 | 67.960 |
| Somewhat not satisfied | 52 | 12.620 | 80.580 |
| Not satisfied at all | 80 | 19.420 | 100.000 |
| Total | 412 | 100.000 | |

**Table 23**

*Level of satisfaction with the current support provided by tax authorities in understanding and fulfilling income tax obligations versus city where entity is located*

| How satisfied are you with the current support and guidance provided by tax | Please indicate the city where the entity is located | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| Very satisfied | 10 | 64 | 5 | 18 | 97 |
| Moderately satisfied | 21 | 49 | 16 | 12 | 98 |
| Unsure/No opinion | 12 | 44 | 7 | 22 | 85 |
| Somewhat not satisfied | 15 | 25 | 2 | 10 | 52 |
| Not satisfied at all | 37 | 22 | 7 | 14 | 80 |
| Total | 95 | 204 | 37 | 76 | 412 |
| Pearson Chi2 = 56.27 Prob = 0.0000 | | | | | |

**Table 24**

*Level of satisfaction with the current support provided by tax authorities in understanding and fulfilling income tax obligations versus type of industry*

| How satisfied are you with the current support and guidance provided by tax | Your company/entity falls under the following class of industry | | | | | |
|---|---|---|---|---|---|---|
| | Service | Manufacturing | Retail | Construction | Real estate | Total |
| Very satisfied | 46 | 1 | 42 | 7 | 1 | 97 |
| Moderately satisfied | 34 | 4 | 49 | 8 | 3 | 98 |
| Unsure/No opinion | 31 | 1 | 48 | 3 | 2 | 85 |
| Somewhat not satisfied | 30 | 8 | 13 | 0 | 1 | 52 |
| Not satisfied at all | 29 | 6 | 37 | 5 | 3 | 80 |
| Total | 170 | 20 | 189 | 23 | 10 | 412 |

Pearson Chi2 = 39.06 Prob = 0.0011

## 4.5 Results per research questions

### 4.5.1 Q1. What are your perceptions of the fairness of the current income tax compliance level on SMEs? What is the level of income tax compliance of SMEs in Malawi?

Respondents were asked whether they find the current income tax system fair and balanced for SMEs in Malawi. From the findings, only 11.65% agreed while 88.35% disagreed. The majority of the respondents who agreed were from the capital city, Lilongwe, followed by Mzuzu (table 27). For those who disagreed, the majority were from the capital city again, followed by Blantyre, Mzuzu and lastly Zomba cities (table 28). In terms of the industry, the majority of those who agreed were from retail, followed by service industry (table 29)

**Table 25**

*The current income tax system is fair and balanced for SMEs*

| Do you believe that the current income tax system is fair and balanced for SMEs? | Freq. | Percent | Cum. |
|---|---|---|---|
| Yes | 48 | 11.65 | 11.65 |
| No | 364 | 88.35 | 100.00 |
| Total | 412 | 100.00 | |

**Table 26**

*The current income tax system is fair and balanced for SMEs*

| Do you believe that the | Please indicate the city where the firm is located |
|---|---|

| current income tax system is fair and balanced for SMEs? | | | | | |
|---|---|---|---|---|---|
| | Blantyre | Lilongwe | Zomba | Mzuzu | Total |
| Yes | 2 | 37 | 1 | 8 | 48 |
| No | 93 | 167 | 36 | 68 | 364 |
| Total | 95 | 204 | 37 | 76 | 412 |

Pearson Chi2 = 19.72 Prob = 0.0002

**Table 27**

*The current income tax system is fair and balanced for SMEs*

| Do you believe that the current income tax system is fair and balanced for SMEs? | Your company/entity falls under the following class of industry | | | | | |
|---|---|---|---|---|---|---|
| | Service | Manufacturing | Retail | Construction | Real estate | Total |
| Yes | 13 | 1 | 29 | 5 | 0 | 48 |
| No | 157 | 19 | 160 | 18 | 10 | 364 |
| Total | 170 | 20 | 189 | 23 | 10 | 412 |

Pearson Chi2 = 9.60 Prob = 0.0476

**4.5.2 Q2. What is the effect of the income tax compliance on the decision-making process of the SME?**

Respondents were asked whether their income tax compliance affected their decision-making processes in any way. The majority (69.83%) stated that they were not affected by their income tax compliance while 30.17% stated that they were (table 30). As part of the explanation, part of those not affected (32.94%) stated that it was because their business evades tax payments and so they are not affected (table 31) while others (14.8%) stated that they are usually aware of any upcoming tax obligations and hence they plan well in advance. Those who stated that they were affected gave the following as the main reasons: taxes make goods and services more expensive; SMEs are charged more, as a result, this affects the growth of the business and because of this less profit is made; the business fails to employ more personnel because money is used for taxes instead (table 31)

**Table 28**

*Whether the income tax compliance has affected your decision-making process, such as hiring new employees, investing in expansion, or introducing new products/services*

| Has income tax compliance affected your decision-making process, such as hiring new employees, investing in expansion, or introducing new products/services? | Freq. | Percent | Cum. |
|---|---|---|---|
| Yes | 124 | 30.17 | 30.17 |
| No | 287 | 69.83 | 100.0 |
| Total | 411 | 100.00 | |

**Table 29**

*Please explain whether income tax affected your decision-making process.*

| Has income tax affected your decision-making process? Please explain | | |
|---|---|---|
| | Frequency | %ge |
| Taxes makes goods and services more expensive | 15 | 3.58 |
| SMEs are charged more, as a result, this is affecting the growth of the business and because of this they make little profit | 18 | 4.30 |
| the business fails to employ more personnel | 55 | 13.13 |
| Because we already know that we have to pay for tax, then we plan it a head of time so it doesn't affect us much | 62 | 14.80 |
| Because it happens that when you want to pay for suppliers of goods at the same time the MRA wants you to pay for your income tax, so in this way your business will be negatively affected | 131 | 31.26 |
| I don't pay so it will difficult to know it's effect | 138 | 32.94 |
| | 419 | 100.00 |

**4.5.3 - Q3. Why are some SMEs not registered for income tax?**

Respondents were asked why some SMEs were not registered for income tax. The survey result showed that majority of respondents (66.83%) were registered for income tax while 33.17% were not (table 32). The survey also found that the majority of tax payers (58.74%) were not knowledgeable of the correct income tax rate while 41.26% were (table 33). The survey results also disclosed that the majority of those registered for tax purposes (56%) were also knowledgeable of the correct income tax rate while 44.00 were not. The majority of those not registered for income tax (88%) are also not knowledgeable of correct income tax rate (table 34). The main reasons for not registering for income tax included the following: the business is small, with little working capital hence not ready to pay tax (24.09%); they don't understand what the Revenue Authority does with the income tax money (17.52%); Income tax rates are too high

(46.72%); The process of registration is long (8.76%) and the feeling that they haven't reached the income tax registration thresh-hold yet (2.92%) (table 35).

**Table 30**

*Registration status with Malawi Revenue Authority*

| Is your SME registered for any tax with Malawi Revenue Authority? | Freq. | Percent | Cum. |
|---|---|---|---|
| Yes | 276 | 66.83 | 66.83 |
| No | 137 | 33.17 | 100.00 |
| Total | 413 | 100.00 | |

**Table 31**

*If your SME is not registered with Malawi Revenue Authority, state why*

| | | |
|---|---|---|
| | Frequency | Percentage |
| Our business is small, with low working capital | 33 | 24.09 |
| We don't understand what the Revenue Authority does with our money | 24 | 17.52 |
| Income tax rates are too high | 64 | 46.72 |
| The process of registration is long | 12 | 8.76 |
| We feel we haven't reached the registration thresh-hold | 4 | 2.92 |
| | 137 | 100.00 |

**Table 32**

*Knowledge of correct income/corporate tax rate you are*

| Do you know the correct income/corporate tax rate you are supposed to pay to Malawi Revenue Authority | Freq. | Percent | Cum. |
|---|---|---|---|
| No | 242 | 58.74 | 58.74 |
| Yes | 170 | 41.26 | 100.00 |
| Total | 412 | 100.00 | |

**Table 33**

*Is your entity registered for any tax with MRA versus*

| Is your entity registered for any tax with MRA? | Do you know the correct income/corporate tax rate you are supposed to pay to Malawi Revenue |
|---|---|

| | Authority? | | |
|---|---|---|---|
| | No | Yes | Total |
| Yes | 121 | 154 | 275 |
| No | 121 | 16 | 137 |
| Total | 242 | 170 | 412 |

Pearson Chi2 = 74.12 Prob = 0.0000

**Table 34**

*Is your entity registered for any tax with MRA versus knowledge of correct income/corporate tax rate*

| Is your entity registered for any tax with MRA? | Do you know the correct income/corporate tax rate you are supposed to pay to Malawi Revenue Authority | | |
|---|---|---|---|
| | No | Yes | Total |
| Yes | 121 | 154 | 275 |
| | 44.00 | 56.00 | 100.00 |
| No | 121 | 16 | 137 |
| | 88.00 | 12.00 | 100.00 |
| Total | 242 | 170 | 412 |

First row has *frequencies* and second row has *row percentages*

**4.5.4 - Q4. What are the challenges faced by SMEs when complying with the existing income tax regime? What can be done to surmount these challenges?**

Respondents were asked to state the challenges they faced when complying with existing income tax laws. The survey result showed the following as some of the main challenges faced: Difficulty in interpreting ambiguous tax guidelines (22.71%); difficulty in understanding complex tax regulations and laws (21.65%); Lack of resources or expertise in-house (14.24%); Keeping up with frequent tax law changes (12.59%); Technology or software-related challenges (6.94%); Calculating accurate deductions and credits (6%); Gathering and organizing necessary financial documents (5.29%); Ensuring timely and accurate filing and payment of taxes (3.29%); Dealing with audits or tax disputes (2.71%); Navigating complex reporting requirements (2.71%) and managing multiple tax obligations (1.88)%.

Regarding what needs to be done in order to surmount the observed challenges, the majority of respondents stated that they wished the Malawi Revenue Authority (MRA) provided special tax training to SME's (45.8%); MRA should simplify the tax law for the understanding of everyone (28.78%); MRA should reduce the income tax rate on small businesses (19.42%); Taxpayers should consider obtaining advice from professionals like Accountants and auditors (2.64%); no idea (0.24%) and taxpayers should keep accurate records (0.24%) (table 38).

**Table 35**

*Challenges faced by SMEs when complying with the existing income tax regime*

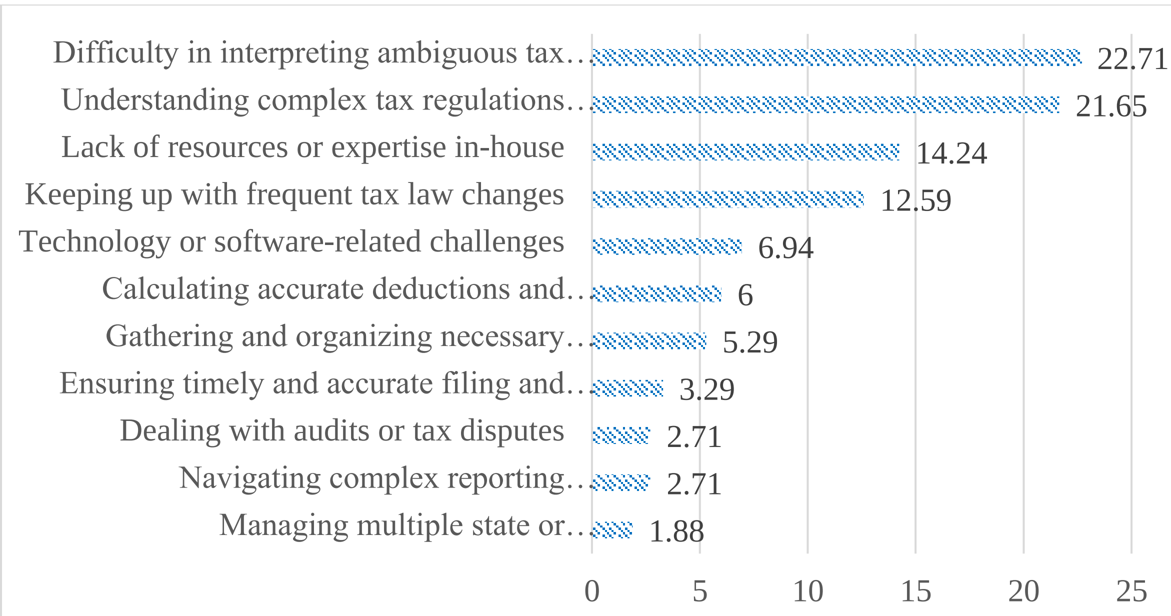



**Table 36**

*What needs to be done to surmount these challenges*

| | Frequency | %ge |
|---|---|---|
| MRA should give a chance to tax payers to pay in installments | 1 | 0.24 |
| MRA should keep it the way it is so that others can find job like accountant | 1 | 0.24 |
| Taxpayers should keep accurate records | 5 | 1.20 |
| No idea | 6 | 1.44 |
| Taxpayers should consider obtaining advice from professionals like Accountants and auditors | 11 | 2.64 |
| MRA should reduce the income tax rate on small businesses | 81 | 19.42 |
| MRA should simplify the tax law for the understanding of every one | 120 | 28.78 |
| MRA should be providing special Training to SME's | 191 | 45.80 |

### 4.5.5 - Q5. What is the relationship between perceived levels of income tax compliance and the sales made by SMEs?

The results disclosed that a total of 40.63% of SMEs were fully compliant with the income tax regime, 18.9% were partially compliant while 40.39% were never compliant (table 39).

The results also indicated that income tax compliance level was related to SME sales (Chi-square test, p-value = 0.000, Table 41). Overall, 25.3% of SMEs agreed that their sales were high enough for their tax compliance level (table 39). Amongst the never compliant group, 10.24% stated that their sales were high enough while for the partially compliant category, this figure was 17.95%. Amongst the fully compliant group, 43.72% agreed that their sales were high enough for their income tax compliance level (table 42). Comparing these three categories of income tax compliance level, the results indicate an increase in sales with increasing income tax compliance level.

**Table 37**

*Rating of the income tax compliance level of your SME entity*

| How would you rate the income tax compliance level of your entity | Freq. | Percent | Cum. |
|---|---|---|---|
| Never complied/Never paid income tax | 166 | 40.39 | 40.39 |
| Partially compliant/partially pays income tax | 78 | 18.98 | 59.37 |
| Fully compliant/fully pays income tax | 167 | 40.63 | 100.00 |
| Total | 411 | 100.00 | |

**Table 38**

*I consider that the sales for our entity are high enough for our tax compliance level*

| I consider that the sales for our entity are high enough for our tax compliance level | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 92 | 22.38 | 22.38 |
| Disagree | 165 | 40.15 | 62.53 |
| I neither agree nor disagree | 50 | 12.17 | 74.70 |
| Agree | 101 | 24.57 | 99.27 |
| Strongly agree | 3 | 0.73 | 100.00 |
| Total | 411 | 100.00 | |

**Table 39**

Rating of the income tax compliance level of your SME entity versus I consider that the sales for our entity are high enough for our tax compliance level

| How would you rate the income tax compliance level of your entity | I consider that the sales for our entity are high enough for our tax compliance level | | | | | |
|---|---|---|---|---|---|---|
| | Strongly disagree | Disagree | I neither agree nor disagree | Agree | Strongly agree | Total |
| Never complied/Never paid income tax | 27 | 88 | 34 | 17 | 0 | 166 |
| Partially compliant/partially pays income tax | 10 | 45 | 9 | 14 | 0 | 78 |
| Fully compliant/fully pays income tax | 55 | 32 | 7 | 70 | 3 | 167 |
| Total | 92 | 165 | 50 | 101 | 3 | 411 |

Pearson Chi2 = 103.69 Prob = 0.0000

**Table 40**

*Rating of the income tax compliance level of your SME entity versus I consider that the sales for our entity are high enough for our tax compliance level with second row as column percentages*

| How would you rate the income tax compliance level of your entity | I consider that the sales for our entity are high enough for our tax compliance | | | | | |
|---|---|---|---|---|---|---|
| | Strongly disagree | Disagree | I neither agree nor disagree | Agree | Strongly agree | Total |
| Never complied/Never paid income tax | 27 | 88 | 34 | 17 | 0 | 166 |
| | 16.27 | 53.01 | 20.48 | 10.24 | 0.00 | 100.00 |
| Partially compliant/partially pays income tax | 10 | 45 | 9 | 14 | 0 | 78 |
| | 12.82 | 57.69 | 11.54 | 17.95 | 0.00 | 100.00 |
| Fully compliant/fully pays income tax | 55 | 32 | 7 | 70 | 3 | 167 |
| | 32.93 | 19.16 | 4.19 | 41.92 | 1.80 | 100.00 |
| Total | 92 | 165 | 50 | 101 | 3 | 411 |
| | 22.38 | 40.15 | 12.17 | 24.57 | 0.73 | 100.00 |

Pearson Chi2 = 103.69 Prob = 0.0000

First row has *frequencies* and second row has *row percentages*

**4.5.6 - Q6. What is the relationship between perceived levels of income tax compliance and profitability of SMEs?**

The results indicated that income tax compliance level was related to SME profitability (Chi-square test, p-value = 0.000, Table 43). Overall, 23.9% of SMEs agreed that their level of profit was high enough for their tax compliance level (table 44). Amongst the never compliant group, 14% agreed that their profitability was high enough and the same percentage of 14% was noted for the partially compliant category. Amongst the fully compliant group, 70% agreed that their profitability was high enough for their income tax compliance level (table 44). Comparing these three categories of income tax compliance level, the results indicate increasing level of profitability increases with increasing income tax compliance level.

**Table 41**

*I consider that the profit for our entity is high enough for our income tax compliance level*

| I consider that the profit for our entity is high enough for our income tax compliance level | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 108 | 26.34 | 26.34 |
| Disagree | 159 | 38.78 | 65.12 |
| I neither agree nor disagree | 45 | 10.98 | 76.10 |
| Agree | 96 | 23.41 | 99.51 |
| Strongly agree | 2 | 0.49 | 100.00 |
| Total | 410 | 100.00 | |

**Table 42**

*I consider that the profit for our entity is high enough versus income tax compliance level with second row as column percentages*

| | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| I consider that the profit for our entity is high enough for our income tax compliance | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 29 | 19 | 60 | 108 |
| | 17.47 | 24.36 | 36.14 | 26.34 |
| Disagree | 93 | 39 | 27 | 159 |
| | 56.02 | 50.00 | 16.27 | 38.78 |
| I neither agree nor disagree | 30 | 6 | 9 | 45 |
| | 18.07 | 7.69 | 5.42 | 10.98 |

| | | | | |
|---|---|---|---|---|
| Agree | 14 | 13 | 69 | 96 |
| | 8.43 | 16.67 | 41.57 | 23.41 |
| Strongly agree | 0 | 1 | 1 | 2 |
| | 0.00 | 1.28 | 0.60 | 0.49 |
| Total | 166 | 78 | 166 | 410 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 103.79 Prob = 0.0000
First row has *frequencies* and second row has *column percentages*

### 4.5.7 - Q7: What is the relationship between tax deterrence instruments/tax morale and income tax compliance level?

*Tax deterrence and tax morale instruments tested*

Tax deterrence instrument tested was in form of high tax rates imposed by the Malawi Revenue Authority (MRA) to tax non-compliant SMEs, whether this was deterrent enough to tax non-compliant SMEs or not. Tax morale instruments tested included current incentives, if any, given by MRA to tax compliant SMEs; the trust tax payers have on their Government of Malawi; satisfaction with how the Government spends tax collected from tax payers in general; perception of respect accorded by society to the respondents and perception of level of tax evasion by society in general, whether the respondents feel that other tax payers evade tax or not.

*Perception of ease with which tax payers find to evade income tax versus income tax compliance*

Ease with which tax payers evade

In general, it was found that 79.47% of tax payers believe that other tax payers find it easy to evade tax (not to pay) in Malawi (table 45). Amongst the never compliant group, 71.08 believe that other tax payers find it easy to evade income tax, followed by the fully compliant ones (70.69%) and lastly the partially compliant (44.87%) (table 46). Comparing these three categories of income tax compliance level, the results suggest increasing belief with reducing level of income tax compliance level.

*Perception of severity of tax penalties from MRA and income tax compliance*

*Ease of Revenue Authority to discover non-compliant tax payers versus income tax compliance*

The study also found that 43.31% of the respondents do not believe that MRA finds it easy to discover tax payers who are not tax compliant and an almost similar number of 42.31% believes that MRA finds it easy to discover tax payers who are not tax compliant (table 47), The belief that MRA finds it easy to discover tax papers who are not tax compliant was found to increase with increasing tax compliance (table 48, Pearson Chi2 = 25.20 Prob = 0.0014)

The study also disclosed that the majority of tax payers (75.92%) consider that tax penalties from MRA are usually high and deterrent (punitive enough) (table 48). This belief was seen to increase with reducing income tax compliance level (table 51, Pearson Chi2 = 42.69 Prob = 0.0000) since the ratio grew from 34% to 45% among the fully compliant and never compliant respectively.

*Incentives from MRA for being income tax compliant versus income tax compliance*

A significant minority of 39.41% believe that there aren't good incentives from MRA for firms that are income tax compliant. Only 26.28% agreed (table 53) while the rest (34.31%) remained neutral. This belief was found to increase proportionately with increasing tax compliance level (table 54, Pearson Chi2 = 120.50 Prob = 0.0000)

*Trust in Government of Malawi and income tax compliance*

When respondents were asked whether they have trust in the Government of Malawi regarding the management of income tax, 84% of them disagreed while only 12.66% of them agreed (table 55). The level of disagreement was found to increase with increasing tax compliance level (Table 56, Pearson Chi2 = 30.45 Prob = 0.0002)

*Satisfaction with the perception of how the Government spend the tax money and income tax compliance*

When respondents were asked whether they are satisfied with the way the Government spends the tax they pay, the majority of them (88.46%) disagreed and only 9.25% agreed. Level of disagreement was found to increase with decreasing level of tax compliance (Table 58, Pearson Chi2 = 26.17 Prob = 0.0010)

*Level of satisfaction with the goods and services being offered by their government and income tax compliance*

Respondents were also asked whether they were satisfied with the goods and services being offered by their government. The majority of them (83.21% disagreed and only 9.74% of them agreed. The level of disagreement was found to increase with increasing level of tax compliance (table 60, Pearson Chi2 = 38.24 Prob = 0.0000)

*How society regards the tax payer in society versus income tax compliance*

When respondents were asked about whether they consider themselves highly regarded/respected in their society versus, the majority of them (77.56%) agreed that they were. Only 10.25% disagreed. The impact on tax compliance between compliant and non-compliant SMEs was found to be mixed (table 63, Pearson Chi2 = 29.02 Prob = 0.0003).

*Perception of widespread income tax evasion versus tax compliance*

When respondents were asked about whether they consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi, 80.24% of them agreed that it was and only 10.73% of them believed that it wasn't. This belief of widespread tax evasion was found to increase with decreasing level of tax compliance (Tax 67, Pearson Chi2 = 84.22 Prob = 0.0000)

**Table 43**

*consider that other tax payers find it easy to evade (not pay) income tax in Malawi*

| I consider that tax payers find it easy to evade (not pay) income tax in Malawi | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 12 | 2.92 | 2.92 |
| Disagree | 89 | 21.65 | 24.57 |
| I neither agree nor disagree | 39 | 9.49 | 34.06 |
| Agree | 225 | 54.74 | 88.81 |
| Strongly agree | 46 | 11.19 | 100.00 |
| Total | 411 | 100.00 | |

**Table 44**

*I consider that tax payers find it easy to evade (not pay) income tax in Malawi versus SME income tax compliance level with second row column percentages*

| I consider that tax payers find it easy to evade (not pay) income tax in Malawi | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never | Partially | Fully | Total |

| | complied/Never paid income tax | compliant/partially pays income tax | compliant/fully pays income tax | |
|---|---|---|---|---|
| Strongly disagree | 3 | 4 | 5 | 12 |
| | 1.81 | 5.13 | 2.99 | 2.92 |
| Disagree | 37 | 21 | 31 | 89 |
| | 22.29 | 26.92 | 18.56 | 21.65 |
| I neither agree nor disagree | 8 | 18 | 13 | 39 |
| | 4.82 | 23.08 | 7.78 | 9.49 |
| Agree | 108 | 29 | 88 | 225 |
| | 65.06 | 37.18 | 52.69 | 54.74 |
| Strongly agree | 10 | 6 | 30 | 46 |
| | 6.02 | 7.69 | 17.96 | 11.19 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 42.69 Prob = 0.0000
First row has *frequencies* and second row has *column percentage*

**Table 45**

*It is easy for MRA to discover tax payers who are not income tax compliant*

| It is easy for MRA to discover tax payers who are not income tax compliant | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 33 | 8.03 | 8.03 |
| Disagree | 142 | 34.55 | 42.58 |
| I neither agree nor disagree | 58 | 14.11 | 56.69 |
| Agree | 174 | 42.34 | 99.03 |
| Strongly agree | 4 | 0.97 | 100.00 |
| Total | 411 | 100.00 | |

**Table 46**

*It is easy for MRA to discover tax payers who are not income tax compliant versus income tax compliance level of your SME entity*

| It is easy for MRA to discover tax payers who are not income tax compliant | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 10 | 8 | 15 | 33 |
| Disagree | 64 | 16 | 62 | 142 |
| I neither agree nor disagree | 25 | 21 | 12 | 58 |

| | | | | |
|---|---|---|---|---|
| Agree | 67 | 32 | 75 | 174 |
| Strongly agree | 0 | 1 | 3 | 4 |
| Total | 166 | 78 | 167 | 411 |

Pearson Chi2 = 25.20 Prob = 0.0014

**Table 47**

*Whether it is easy for MRA to discover tax payers who are not income tax compliant versus SME income tax compliance level with second row as column percentages*

| It is easy for MRA to discover tax payers who are not income tax compliant | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 10 | 8 | 15 | 33 |
| | 6.02 | 10.26 | 8.98 | 8.03 |
| Disagree | 64 | 16 | 62 | 142 |
| | 38.55 | 20.51 | 37.13 | 34.55 |
| I neither agree nor disagree | 25 | 21 | 12 | 58 |
| | 15.06 | 26.92 | 7.19 | 14.11 |
| Agree | 67 | 32 | 75 | 174 |
| | 40.36 | 41.03 | 44.91 | 42.34 |
| Strongly agree | 0 | 1 | 3 | 4 |
| | 0.00 | 1.28 | 1.80 | 0.97 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 25.20 Prob = 0.0014

First row has *frequencies* and second row has *column percentages*

**Table 48**

*I consider that tax penalties from MRA are usually low and non-deterrent (not punitive enough)*

| I consider that tax penalties from MRA are usually low and non-deterrent (not punitive enough) | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 41 | 9.98 | 9.98 |
| Disagree | 230 | 55.96 | 65.94 |
| I neither agree nor disagree | 57 | 13.87 | 79.81 |
| Agree | 79 | 19.22 | 99.03 |
| Strongly agree | 4 | 0.97 | 100.00 |
| Total | 411 | 100.00 | |

**Table 49**

*I consider that tax penalties from MRA are usually low and non-deterrent (not punitive enough) versus SME income tax compliance level*

| I consider that tax penalties from MRA are usually low and non-deterrent (not punitive enough) | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 12 | 13 | 16 | 41 |
| Disagree | 110 | 42 | 78 | 230 |
| I neither agree nor disagree | 25 | 12 | 20 | 57 |
| Agree | 18 | 10 | 51 | 79 |
| Strongly agree | 1 | 1 | 2 | 4 |
| Total | 166 | 78 | 167 | 411 |
| Pearson Chi2 = 30.53 Prob = 0.0002 | | | | |

**Table 50**

*I consider that tax penalties from MRA are usually low and non-deterrent (not punitive enough) versus SME income tax compliance level with second row as column percentages.*

| I consider that tax penalties from MRA are usually low and non-deterrent (n | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 12 | 13 | 16 | 41 |
| | 29.27 | 31.71 | 39.02 | 100.00 |
| Disagree | 110 | 42 | 78 | 230 |
| | 47.83 | 18.26 | 33.91 | 100.00 |
| I neither agree nor disagree | 25 | 12 | 20 | 57 |
| | 43.86 | 21.05 | 35.09 | 100.00 |
| Agree | 18 | 10 | 51 | 79 |
| | 22.78 | 12.66 | 64.56 | 100.00 |
| Strongly agree | 1 | 1 | 2 | 4 |
| | 25.00 | 25.00 | 50.00 | 100.00 |
| Total | 166 | 78 | 167 | 411 |
| | 40.39 | 18.98 | 40.63 | 100.00 |
| Pearson Chi2 = 30.53 Prob = 0.0002 | | | | |

First row has *frequencies* and second row has *row percentages*

**Table 51**

*There are good incentives from MRA for firms that are income tax compliant*

| There are good incentives from MRA for firms that are income tax compliant | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 46 | 11.19 | 11.19 |
| Disagree | 116 | 28.22 | 39.42 |
| I neither agree nor disagree | 141 | 34.31 | 73.72 |
| Agree | 102 | 24.82 | 98.54 |
| Strongly agree | 6 | 1.46 | 100.00 |
| Total | 411 | 100.00 | |

**Table 52**

*There are good incentives from MRA for firms that are income tax compliant versus SME income tax compliance level with second row as column percentages*

| | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| There are good incentives from MRA for firms that are income tax compliant | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 18 | 19 | 9 | 46 |
| | 10.84 | 24.36 | 5.39 | 11.19 |
| Disagree | 39 | 27 | 50 | 116 |
| | 23.49 | 34.62 | 29.94 | 28.22 |
| I neither agree nor disagree | 93 | 23 | 25 | 141 |
| | 56.02 | 29.49 | 14.97 | 34.31 |
| Agree | 15 | 8 | 79 | 102 |
| | 9.04 | 10.26 | 47.31 | 24.82 |
| Strongly agree | 1 | 1 | 4 | 6 |
| | 0.60 | 1.28 | 2.40 | 1.46 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 120.50 Prob = 0.0000

First row has *frequencies* and second row has *column percentages*

**Table 53**

*I have trust in the Government of Malawi regarding the management of income*

| I have trust in the Government of Malawi regarding the management of income | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 218 | 53.04 | 53.04 |
| Disagree | 129 | 31.39 | 84.43 |
| I neither agree nor disagree | 12 | 2.92 | 87.35 |
| Agree | 50 | 12.17 | 99.51 |
| Strongly agree | 2 | 0.49 | 100.00 |
| Total | 411 | 100.00 | |

**Table 54**

*I have trust in the Government of Malawi regarding the management of income tax versus SME income tax compliance level with second row as column percentages*

| | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| I have trust in the Government of Malawi regarding the management of income tax | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 85 | 27 | 106 | 218 |
| | 51.20 | 34.62 | 63.47 | 53.04 |
| Disagree | 57 | 40 | 32 | 129 |
| | 34.34 | 51.28 | 19.16 | 31.39 |
| I neither agree nor disagree | 4 | 3 | 5 | 12 |
| | 2.41 | 3.85 | 2.99 | 2.92 |
| Agree | 20 | 8 | 22 | 50 |
| | 12.05 | 10.26 | 13.17 | 12.17 |
| Strongly agree | 0 | 0 | 2 | 2 |
| | 0.00 | 0.00 | 1.20 | 0.49 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 30.45 Prob = 0.0002

First row has *frequencies* and second row has *column percentages*

**Table 55**

*I am satisfied with the way the Government spends the tax I pay*

| I am satisfied with the way the Government | Freq. | Percent | Cum. |
|---|---|---|---|

| spends the tax I pay | | | |
|---|---|---|---|
| Strongly disagree | 221 | 53.77 | 53.77 |
| Disagree | 143 | 34.79 | 88.56 |
| I neither agree nor disagree | 9 | 2.19 | 90.75 |
| Agree | 35 | 8.52 | 99.27 |
| Strongly agree | 3 | 0.73 | 100.00 |
| Total | 411 | 100.00 | |

**Table 56**

*I am satisfied with the way the Government spends the tax I pay versus SME income tax compliance level with second column as percentages*

| | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| I am satisfied with the way the Government spends the tax I pay | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 78 | 33 | 110 | 221 |
| | 46.99 | 42.31 | 65.87 | 53.77 |
| Disagree | 71 | 37 | 35 | 143 |
| | 42.77 | 47.44 | 20.96 | 34.79 |
| I neither agree nor disagree | 2 | 2 | 5 | 9 |
| | 1.20 | 2.56 | 2.99 | 2.19 |
| Agree | 14 | 6 | 15 | 35 |
| | 8.43 | 7.69 | 8.98 | 8.52 |
| Strongly agree | 1 | 0 | 2 | 3 |
| | 0.60 | 0.00 | 1.20 | 0.73 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 26.17 Prob = 0.0010

First row has *frequencies* and second row has *column percentages*

**Table 57**

*I am satisfied with the goods and services being offered by the Government*

| I am satisfied with the goods and services being offered by the Government | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 194 | 47.20 | 47.20 |
| Disagree | 148 | 36.01 | 83.21 |
| I neither agree nor disagree | 29 | 7.06 | 90.27 |
| Agree | 38 | 9.25 | 99.51 |
| Strongly agree | 2 | 0.49 | 100.00 |
| Total | 411 | 100.00 | |

**Table 58**

*I am satisfied with the goods and services being offered by the Government versus SME income tax compliance level*

| I am satisfied with the goods and services being offered by the Government | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/ Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/full y pays income tax | Total |
| Strongly disagree | 68 | 23 | 103 | 194 |
| Disagree | 66 | 42 | 40 | 148 |
| I neither agree nor disagree | 17 | 7 | 5 | 29 |
| Agree | 15 | 6 | 17 | 38 |
| Strongly agree | 0 | 0 | 2 | 2 |
| Total | 166 | 78 | 167 | 411 |

Pearson Chi2 = 38.24 Prob = 0.0000

**Table 59**

*I am satisfied with the goods and services being offered by the Government versus SME income tax compliance, with second rows as column percentages*

| I am satisfied with the goods and services being offered by the Government | E_1. How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 68 | 23 | 103 | 194 |
| | 40.96 | 29.49 | 61.68 | 47.20 |
| Disagree | 66 | 42 | 40 | 148 |
| | 39.76 | 53.85 | 23.95 | 36.01 |
| I neither agree nor disagree | 17 | 7 | 5 | 29 |
| | 10.24 | 8.97 | 2.99 | 7.06 |
| Agree | 15 | 6 | 17 | 38 |
| | 9.04 | 7.69 | 10.18 | 9.25 |
| Strongly agree | 0 | 0 | 2 | 2 |
| | 0.00 | 0.00 | 1.20 | 0.49 |
| Total | 166 | 78 | 167 | 411 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 38.24 Prob = 0.0000
First row has *frequencies* and second row has *column percentages*

**Table 60**

*I am highly regarded/respected in my society.*

| I am highly regarded/respected in my society. | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 7 | 1.71 | 1.71 |
| Disagree | 35 | 8.54 | 10.24 |
| I neither agree nor disagree | 50 | 12.20 | 22.44 |
| Agree | 301 | 73.41 | 95.85 |
| Strongly agree | 17 | 4.15 | 100.00 |
| Total | 410 | 100.00 | |

**Table 61**

*I am highly regarded/respected in my society versus SME income tax compliance level*

| I am highly regarded/respected in my society. | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/ Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 1 | 4 | 2 | 7 |
| Disagree | 18 | 9 | 8 | 35 |
| I neither agree nor disagree | 12 | 12 | 26 | 50 |
| Agree | 130 | 45 | 126 | 301 |
| Strongly agree | 4 | 8 | 5 | 17 |
| Total | 165 | 78 | 167 | 410 |

Pearson Chi2 = 29.02 Prob = 0.0003

**Table 62**

*I am highly regarded/respected in my society versus SME income tax compliance level with rows as column percentages*

| I am highly regarded/respected in my society. | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 1 | 4 | 2 | 7 |
| | 0.61 | 5.13 | 1.20 | 1.71 |

| | | | | |
|---|---|---|---|---|
| Disagree | 18 | 9 | 8 | 35 |
| | 10.91 | 11.54 | 4.79 | 8.54 |
| I neither agree nor disagree | 12 | 12 | 26 | 50 |
| | 7.27 | 15.38 | 15.57 | 12.20 |
| Agree | 130 | 45 | 126 | 301 |
| | 78.79 | 57.69 | 75.45 | 73.41 |
| Strongly agree | 4 | 8 | 5 | 17 |
| | 2.42 | 10.26 | 2.99 | 4.15 |
| Total | 165 | 78 | 167 | 410 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 29.02 Prob = 0.0003

First row has *frequencies* and second row has *column percentages*

**Table 63**

*I consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi.*

| I consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi. | Freq. | Percent | Cum. |
|---|---|---|---|
| Strongly disagree | 16 | 3.90 | 3.90 |
| Disagree | 28 | 6.83 | 10.73 |
| I neither agree nor disagree | 37 | 9.02 | 19.76 |
| Agree | 216 | 52.68 | 72.44 |
| Strongly agree | 113 | 27.56 | 100.00 |
| Total | 410 | 100.00 | |

**Table 64**

*I consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi versus SME income tax compliance level.*

| I consider that income tax evasion (deliberate non-payment of tax) is widespread in Malawi. | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 5 | 9 | 2 | 16 |
| Disagree | 10 | 9 | 9 | 28 |
| I neither agree nor disagree | 10 | 10 | 17 | 37 |
| Agree | 116 | 42 | 58 | 216 |
| Strongly agree | 25 | 8 | 80 | 113 |
| Total | 166 | 78 | 166 | 410 |

Pearson Chi2 = 84.22 Prob = 0.0000

**Table 65**

*I consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi versus SME income tax compliance level with row as column percentages*

| I consider that income tax evasion (deliberate non-payment of tax) is wide | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Strongly disagree | 5 | 9 | 2 | 16 |
| | 3.01 | 11.54 | 1.20 | 3.90 |
| Disagree | 10 | 9 | 9 | 28 |
| | 6.02 | 11.54 | 5.42 | 6.83 |
| I neither agree nor disagree | 10 | 10 | 17 | 37 |
| | 6.02 | 12.82 | 10.24 | 9.02 |
| Agree | 116 | 42 | 58 | 216 |
| | 69.88 | 53.85 | 34.94 | 52.68 |
| Strongly agree | 25 | 8 | 80 | 113 |
| | 15.06 | 10.26 | 48.19 | 27.56 |
| Total | 166 | 78 | 166 | 410 |
| | 100.00 | 100.00 | 100.00 | 100.00 |

Pearson Chi2 = 84.22 Prob = 0.0000

First row has *frequencies* and second row has *column percentages*

**4.5.8 - Q8. What is the relationship between moderating variables (age, gender, level of education and SME size) and income tax compliance level? (Section A versus E1)**

Moderating variables identified by this study include age, gender, level of education of SME respondents as well as relative size of SMEs. These were considered in light of their perceptions on the impact of SME income tax compliance.

*Gender and Income tax compliance level*

The research survey findings revealed that 57.14% of the respondents were males while 42.86% were females (Table 68). This clearly shows that males dominated the operations of SMEs in Malawi.

The study disclosed overall higher non-compliance in females than in males as 42.94% of females never paid income tax against 38.46% of their male counterparts (table 69). When full compliance is considered, the 36.13 were found to be fully compliant for females against 44.02% for their male counterparts. (Table 69, Pearson Chi2 = 2.64 Prob = 0.2672)

The study also had more youthful females in comparison to males as 67.23% of the females were in the young category against 56.78% of their male counterparts (table 70).

**Table 66**

*Please indicate the gender of the respondent*

| Please indicate the gender of the respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| Female | 177 | 42.86 | 42.86 |
| Male | 236 | 57.14 | 100.00 |
| Total | 413 | 100.00 | |

**Table 67**

*Gender of the respondent versus SME income tax compliance level with second row as row percentages*

| A1. Please indicate the gender of the respondent | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Female | 76 | 37 | 64 | 177 |
| | 42.94 | 20.90 | 36.16 | 100.00 |
| Male | 90 | 41 | 103 | 234 |
| | 38.46 | 17.52 | 44.02 | 100.00 |
| Total | 166 | 78 | 167 | 411 |
| | 40.39 | 18.98 | 40.63 | 100.00 |
| Pearson Chi2 = 2.64 Prob = 0.2672 | | | | |

First row has *frequencies* and second row has *row percentages*

**Table 68**

*Age category versus gender*

| Age category of respondent | Please indicate the gender of the respondent | | |
|---|---|---|---|
| | Female | Male | Total |
| young | 119 | 134 | 253 |
| | 67.23 | 56.78 | 61.26 |
| old | 58 | 102 | 160 |
| | 32.77 | 43.22 | 38.74 |
| Total | 177 | 236 | 413 |
| | 100.00 | 100.00 | 100.00 |

First row has *frequencies* and second row has *column percentages*

*Level of education*

The study analyzed the academic qualifications of the SME respondents. According to the findings, 44.79% of the respondents were secondary school graduates; 28.09% had college diplomas, 19.61% of the respondents were holders of undergraduate degrees and 1.21% of respondents had Masters Degrees. The study also revealed that 0.24% of respondents (one respondents) had Doctorate degrees (Table 71).

Table 69

*Level of education*

| Please indicate the level of education of respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| Primary | 25 | 6.05 | 6.05 |
| Secondary | 185 | 44.79 | 50.85 |
| Diploma | 116 | 28.09 | 78.93 |
| Undergraduate Degree | 81 | 19.61 | 98.55 |
| Master's Degree | 5 | 1.21 | 99.76 |
| Doctorate | 1 | 0.24 | 100.00 |
| Total | 413 | 100.00 | |

**4.6 Level of education and income tax compliance**

The study analyzed the academic qualifications relative to income tax compliance. According to the findings, 60% of the primary school dropouts were never compliant. This percentage reduces to 44.26% for Secondary School leavers and 37.93% for diploma holders, 29.63% for undergraduate degree holders and, 20% for Master’s degree holders and 0% for PhD holder. Income tax non-compliance is seen to decrease with increasing level of education. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing level of education (Table 72 Pearson Chi2 = 25.62 Prob = 0.0043).

**Table 70**

*Level of education versus SME income tax compliance level with second rows as row percentages*

| Please indicate the level of | How would you rate the income tax compliance level of |
|---|---|

| education of respondent | your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| Primary | 15 | 3 | 7 | 25 |
| | 60.00 | 12.00 | 28.00 | 100.00 |
| Secondary | 81 | 30 | 72 | 183 |
| | 44.26 | 16.39 | 39.34 | 100.00 |
| Diploma | 44 | 16 | 56 | 116 |
| | 37.93 | 13.79 | 48.28 | 100.00 |
| Undergraduate Degree | 24 | 26 | 31 | 81 |
| | 29.63 | 32.10 | 38.27 | 100.00 |
| Master's Degree | 1 | 3 | 1 | 5 |
| | 20.00 | 60.00 | 20.00 | 100.00 |
| Doctorate | 0 | 0 | 1 | 1 |
| | 0.00 | 0.00 | 100.00 | 100.00 |
| Total | 166 | 78 | 167 | 411 |
| | 40.39 | 18.98 | 40.63 | 100.00 |
| Pearson Chi2 = 25.62 Prob = 0.0043 | | | | |

First row has *frequencies* and second row has *row percentages*

*Age of respondents*

The age categories of respondents of the study are analyzed in table 71. According to the results, the majority of the respondents (61.26) were aged below 40 years (youth age group) while 38.74% were aged above 40 years (old age category).

**Table 71**

*Age category of respondents*

| Age category of respondent | Freq. | Percent | Cum. |
|---|---|---|---|
| young | 253 | 61.26 | 61.26 |
| old | 160 | 38.74 | 100.00 |
| Total | 413 | 100.00 | |
| | | | |

*Age of respondents and income tax compliance*

The study analyzed the age of respondents relative to income tax compliance. According to the findings, 44% of the youth were never compliant against 34.38% of the old. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing age, with 36.25% for the young and 47.5% for the old (Table 74 Pearson Chi2 = 5.49 Prob = 0.0643).

**Table 72**

*Age of respondent versus SME income tax compliance level*

| Age category of respondent | How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| young | 111 | 49 | 91 | 251 |
| | 44.22 | 19.52 | 36.25 | 100.00 |
| old | 55 | 29 | 76 | 160 |
| | 34.38 | 18.13 | 47.50 | 100.00 |
| Total | 166 | 78 | 167 | 411 |
| | 40.39 | 18.98 | 40.63 | 100.00 |
| Pearson Chi2 = 5.49 Prob = 0.0643 | | | | |

*SME size*

Respondents of the research were asked to indicate their size in employee number terms. According to the findings, 52.54% of the entities sampled were considered as small while 47.46% were considered as medium.

**Table 73**

*Size of SME*

| Size of SME | Freq. | Percent | Cum. |
|---|---|---|---|
| Small | 217 | 52.54 | 52.54 |
| medium | 196 | 47.46 | 100.00 |
| Total | 413 | 100.00 | |

*SME size and income tax compliance*

The study analyzed the SME size relative to income tax compliance. According to the findings, 59.72% of the small entities were never compliant against 18.97% of the medium ones. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing SME size, with 29.17% for the small and 53.33% for the medium (Table 77 Pearson Chi2 = 71.71 Prob = 0.0000).

**Table 74**

*Size of SME versus income tax compliance level*

| Size of SME | E_1. How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| small | 129 | 24 | 63 | 216 |
| medium | 37 | 54 | 104 | 195 |
| Total | 166 | 78 | 167 | 411 |
| Pearson Chi2 = 71.71 Prob = 0.0000 | | | | |

**Table 75**

*Size of SME versus income tax compliance level with second row as column percentages*

| Size of SME | E_1. How would you rate the income tax compliance level of your entity | | | |
|---|---|---|---|---|
| | Never complied/Never paid income tax | Partially compliant/partially pays income tax | Fully compliant/fully pays income tax | Total |
| small | 129 | 24 | 63 | 216 |
| | 59.72 | 11.11 | 29.17 | 100.00 |
| medium | 37 | 54 | 104 | 195 |
| | 18.97 | 27.69 | 53.33 | 100.00 |
| Total | 166 | 78 | 167 | 411 |
| | 40.39 | 18.98 | 40.63 | 100.00 |
| Pearson Chi2 = 71.71 Prob = 0.0000 | | | | |

First row has *frequencies* and second row has *row percentage*

### 4.6 Evaluation of findings

This section is an evaluation of findings of this thesis. The section is divided into three more subsections. The first sub-section provides an evaluation of SME general tax compliance theories.

This is followed by an evaluation of income tax compliance level in Malawi, followed by impact of income tax compliance on sales and profitability of SMEs in Malawi.

#### 4.6.1 Discussion of findings

The results discussions are centered on the eight Research study questions, which are in turn taken from the following research objective: To assess the perceived impact of income tax compliance level on the financial performance of SMEs in Malawi during the year ended 31st December 2022.

From the above-mentioned study objective, the eight research questions were formulated and tested and the results are now discussed below:

4.6.1.1 - Q1. What are your perceptions of the fairness of the current income tax system on

SMEs and what is your income tax compliance level?

It was found that the majority of taxpayers (88.35%) do not find the current income tax system fair on SMEs and only 11.65% did. The majority of the respondents who disagreed were from the capital city, Lilongwe, followed by Blantyre, Mzuzu and lastly Zomba (table 28). In terms of the industry, the majority of those who disagreed were from retail, followed by service industry (table 29). (Table 31)

The observed study result agrees with other studies carried out in Nigeria which established "that SMEs find tax systems complicated and place disproportionate pressure on smaller businesses. Small taxpayers under the regular system of taxation are discriminated against, since the compliance requirements, cost of compliance and tax rate are the same for both small and large enterprises" (Atawodi & Ojeka (2012), Olawale and Garwe (2017).

Indeed, studies by Schnellenbach (2006) and Lago et al (2010) concluded that unfair tax systems encourage tax non-compliance as tax is reflected as a tool by a monster government which is concerned with only increasing the tax collected without any regard to policies considered as fair by the taxpayers. A study in Nigeria which was done by Atawodi and others (2012) also found that SMEs considered the Nigerian Tax system complex. It can be stated that a tax system which is complex puts unequal stress especially on small and medium entities who may not have the capacity and capability to either employ expert tax specialist or hire one because of the high cost involved, thereby making SMEs consider the whole tax system as unfair, only favoring entities considered large. The result is also in agreement with another study by Güzel et al (2019) which was about the income tax compliance behavior of independent accounting professionals revealed that the effects of the variables of tax justice perception and trust in government on tax compliance had an impact on income tax compliance. 392 independent accounting professionals in Turkey were taken as samples to examine the relationships between the variables of tax compliance, perception of tax justice, and trust in government. The data obtained from this sample were examined using correlation, factor and regression analysis. The findings obtained as a result of the analysis revealed that firstly there is a positive and statistically significant relationship of the trust in government on tax compliance through tax justice perception (mediation), secondly, there is a positive and statistically significant relationship of the trust in government on the tax compliance, and thirdly and finally there is a positive and statistically significant relationship of the trust in government on the perception of tax justice. It is therefore concluded that income tax systems which are considered unfair have a negative impact on income tax compliance.

It was also found that the level of income tax compliance, in full compliance of the adopted definition of income tax compliance, was very low. SMEs full income tax compliance was found to be at the rate of 40.63% while 18.9% of them were found to be only partially compliant and 40.39% were found to be never compliant.

The low-income tax compliance was found to be from perceived poor implementation of general tax deterrence elements by the Malawi Revenue Authority and behavioral aspects of income tax compliance called “Tax morale” where tax payers fared poorly. Regarding weak implementation of general tax deterrence instruments by the tax authority, SMEs found income tax rates to be too high. SMEs also found the overall tax system to be unfair to SMEs and favoring large entities instead, did not believe that other tax payers are faithful in their payment of tax, believed that other tax payers find it easy to evade tax, believed that it is not easy for MRA to discover non-compliant tax payers, tax penalties are not high enough; MRA does not provide good tax payer education to SMEs in Malawi. Regarding poor regard of behavioral aspects (tax morale), SMEs stated that they do not have trust in their government regarding the implementation of public goods and services using their taxes, are not contented with the manner their government spends their taxes, consider that income tax evasion is widespread in Malawi and believe that the Malawi income tax system places a heavy burden on SMEs as compared to larger entities.

4.6.1.2 - Q2. What is the effect of the perceived income tax compliance on the decision-making process of the SME?

It was found that the majority (69.83%) of SME tax payers were not affected by their income tax compliance, meaning, there was no effect of the perceived income tax compliance on their decision making, while only 30.17% were (table 30). As part of the explanation, part of those not affected (32.94%) specified that it was because their business evades tax payments and so they are not affected (table 31) while others (14.8%) specified that they are usually aware of any upcoming tax obligations and hence they plan well in advance. This result is not surprising considering the low overall income tax compliance level observed in this study. It is to be noted that a number of studies found that “taxpayers evade taxes when they are of the belief that tax evasion is prevalent” (Luttmer & Singhal 2014, p. 8). The majority of tax payers stated that their tax compliance status did not affect their decision-making processes simply because approximately 60% of SME tax payers in Malawi are not fully compliant.

Those who stated that they were affected gave the following as the main reasons: taxes make goods and services more expensive; SMEs are charged more, as a result, this affects the growth of the business and because of this, less profit is made; the business fails to employ more personnel because money is used for taxes instead (table 31).

Studies by Mnewa and Maliti (2008) presented that several SMEs remain unlikely to achieve the desired growth trends and profitability levels due to unfavorable tax policies. It can therefore be argued that it is critical for any Government to consider carefully, aspects which may influence on efficiency, economy and effectiveness of the smaller organizations. This is because, According to Miller and Wongsaroj (2018), small and medium entities still remain key to economic growth of all nations, both developing plus developed. According to UNIDO (2009), small and medium organizations represent over 90% of private businesses and they contribute to more than 50% of employment and GDP in most African countries” (p. 2).

In Ghana, smaller entities characterized by the “production landscape have been noted to provide about 85% of manufacturing employment” (Aryeetey et al 2004). SMEs also “contribute about 70% to Ghana’s GDP and they account for over 90% of businesses in Ghana” (Aryeetey et al 2004). From the above statements, it can therefore be argued that SMEs wield a vital role in motivating progress, creating work and contributing to alleviation of poverty, considering their commercial weight

4.6.1.3 - Q3. Why are some SMEs not registered for income tax?

The survey result showed that majority of respondents (66.83%) were registered for income tax while 33.17% were not (table 32). The survey also found that the majority of tax payers (58.74%) were not knowledgeable of the correct income tax rate while 41.26% were (table 33). The survey results also disclosed that the majority of those registered for tax purposes (56.00) were also knowledgeable of the correct income tax rate while 44.00 were not. The majority of those not registered for income tax (88%) are also not knowledgeable of correct income tax rate (table 34).

The main reasons for not registering for income tax included the following: the business is small, with little working capital hence not ready to pay tax (24.09%); they don't understand what the Revenue Authority does with the income tax money (17.52%); Income tax rates are too high (46.72%); The process of registration is long (8.76%) and the feeling that they haven't reached the income tax registration thresh-hold yet (2.92%) (table 35). he economic industry in Malawi is made up of practically Micro, small and medium sized entities (MSMEs). As per the world bank report of May, 2022, the 2019 Finscope Micro, Small and Medium Enterprises (MSMEs) report estimated that there were about 1.6 million MSMEs in the Malawi which employed about 1.8 million people in total. This report established that approximately 74% (1,184,000) of the enterprises were micro enterprises, 23% (368,000) were small enterprises and only 3% (48,000) were considered as medium enterprises. The report estimated that the Micro, Small and Medium Enterprise sector "contributes about 40% of gross domestic product (GDP) and 24% of employment, and that about 21% of the country's adult population derives their livelihood from the sector". This level of contribution cannot be said to be small. It can be said the SME industry in Malawi is the biggest.

So, indeed the majority of respondents consider that the income tax rates in the country are too high. This finding is in agreement with that of Chipeta (2002), Farzbod (2000), Atawodi (2012), Yee (2017) and Kurawa (2018) who noted that exorbitant tax rates as being the reason for tax evasion in Africa. Whenever income tax rates are forced at upper rates on the poor SMEs, it becomes impossible for these SMEs to remit the amounts assessed, as a result, they become forced to depart from their self-esteem and instead resort to unethical tax avoidance measures. As a direct result of the same, tax evasion arises as an acceptable norm (Yee, 2017 and Rantelangi and Majid 2018). Locally, a study by Chipeta (2002) observed that the fundamental reasons for evading income tax was exorbitant rates of tax. Chipeta (2002) also noted that “a higher tax rate increases the burden of the tax payer and reduces his disposable income hence, the probability of evading tax is higher” (p. 2).

A study by Fanny (2019) examined “features influencing the income tax compliance of small and medium sized entities (SMEs) for income-tax reporting requirements” in Indonesia. Using multiple regressions, six tax compliance factors were examined. Data was collected through a survey conducted in Jakarta using 328 respondents who were all small business taxpayers. A researcher administered questionnaire survey method was used for data collection. The results revealed that referral groups, the probability of audit, tax knowledge, tax rates and the perception of equity and fairness have a significant impact on tax compliance. In particular, the referral group had the most significant influence on the noncompliance behavior of SME taxpayers as well as the perceived high income tax rates. High income tax rates were said to be the reason for lower tax compliance. Another study by Siti et al (2020) in Indonesia in the region of Yogyakarta, a region with bulging Small and Medium Entities in Indonesia, invited the vital questions of whether the implementation of the “new SMEs tax regulations in the region impacts the intensification of final income tax and tax compliance. The study aimed at analyzing the relationship between the amendments of the final income tax policy and the legal compliance of SME taxpayers. The research used a juridical and empirical approach. Empirical data was collected by interview and questionnaire to seven taxpayers, while juridical data was obtained by analyzing the Government Policy on taxation. The study showed that a reduction of the final income tax tariff from 1% to 0.5% and the existence of legal certainty regarding the taxation time frame resulted into a positive impact on taxpayer compliance. This was demonstrated by the fact that the number of taxpayers in 2019 increased by 15% when compared to 2017. However, tariff reduction was not the only solution to the non-compliant taxpayer. The Regional Office of the Directorate General of Taxes still found that some SMEs were involved in tax avoidance schemes, that they were still not tax compliant. This suggests that the government needs to conduct a more cooperative approach” by finding other reasons for income tax noncompliance as a tax reduction rate only still results into some SMEs not being tax compliant.

Since the SMEs consider income tax rates to be too high, then there is a high chance for them to do everything possible to evade tax and this would result into narrowing of the tax base by the Malawi revenue Authority, hence having an overall negative effect on the national economy".
Ahangar, Bandpey, & Rokny, (2011) shared their findings with other researchers on the positive relationship between tax rate and tax non-compliance such. The results of their study disclosed that increase in tax rate would lead to increase in number of tax non-compliance and vice versa. In term of cost of hiring tax agent, it is found out too by Trivedi, Shehata, and Mestelmen (2014) that individual taxpayers are reluctant to engage with tax agent rather than self-complete tax returns due to the fact that they feel that it is a waste of money to employ tax agent services. Another research found that smaller entities, especially SMEs and self-employed workers, paid more tax compliance costs than larger entities as a result of the fact that they had to hire tax preparers, as they did not have access to inhouse tax consultants. In reality, SME taxpayers might encounter financial difficulty as a consequence of proportionately higher compliance costs (Isa, 2014) and as a result, their tax compliance levels may be reduced (Arachi, & Santoro, 2007).
Another study in Uganda, Kenya, Tanzania and South Africa by Ali et al (2015) regarding the attitude of Residents towards tax disclosed that "participants that are happy in the way their country is providing services like health and learning had a "more compliant attitude of 6% and 9%, respectively" (p. 87). In Kenya, participants who are happy with the way the Government is providing roads and educational services have compliance outlook of 11%. In the Republic of South Africa, taxpayers that were happy in the way their country offered various services like dispensing of identity cards as well as receiving household and policing services were more tax compliant. These results suggest that national expenses can inspire tax compliance in general, suggesting that a country like Malawi, can cultivate a more tax compliant attitude by offering services which residents require in an effective and manageable manner.

Ali, Fjeldstad, and Sjursen (2015) propose that there is a significant correlation between the belief that one's own ethnic group is being treated unfairly and having a tax-compliant attitude in both South Africa and Tanzania. Specifically, for each point increase in the perception of unfair treatment of one's ethnic group, the probability of maintaining a tax-compliant attitude decreases by 6% in both South Africa and Tanzania.
This observation lends support to the comparative treatment model, which is grounded in equity theory and suggests that rectifying imbalances in the relationship between the government and

taxpayers is crucial for fostering tax compliance (Persson, 2008; Rothstein, 2008). However, it is worth noting that this association was not evident in Uganda and Kenya, as this study did not yield any significant findings in those regions. On the other hand, in Tanzania, an increase in the approval of the overall performance of political figures was found to enhance the likelihood of adopting a tax-compliant attitude by more than 3%.

#### *4.6.1.4 - Q4. What are the challenges faced by SMEs when complying with the existing income tax regime? What can be done to surmount these challenges?*

The survey result showed the following as some of the main challenges faced by SMEs when complying with the existing income tax regime: Difficulty in interpreting ambiguous tax guidelines (22.71%); Understanding complex tax regulations and laws (21.65%); Lack of resources or expertise in-house (14.24%); Keeping up with frequent tax law changes (12.59%); Technology or software-related challenges (6.94%); Calculating accurate deductions and credits (6%); Gathering and organizing necessary financial documents (5.29%); Ensuring timely and accurate filing and payment of taxes (3.29%); Dealing with audits or tax disputes (2.71%); Navigating complex reporting requirements (2.71%) and managing multiple tax obligations (1.88)%.

Regarding what needs to be done in order to surmount the observed challenges, the majority of respondents stated that they wished the Malawi Revenue Authority (MRA) provided special tax training to SME's (45.8%); MRA should simplify the tax law for the understanding of everyone (28.78%); MRA should reduce the income tax rate on small businesses (19.42%); Taxpayers should consider obtaining advice from professionals like Accountants and auditors (2.64%); no idea (0.24%) and taxpayers should keep accurate records (0.24%) (table 38).

The finding is in agreement with studies done in other African countries which noted that most SMEs do not have adequate capability to conform to various and complex tax laws (Martin, 2010, Pope and Abdul 2008, Atawodi 2012, Kurawa 2018). Lack of knowledge in tax law would definitely affect the implementation of tax laws consequently, enabling more SMEs to be breaking the law due to ignorance. This affects the collection of taxes among these SMEs. Tax laws, together with related rules and principles, should be coherent and understandable to taxpayers; meaning, they should be as straight forward and as clear-cut and definite to both the tax-payer and the revenue Authority. It can however be argued that tax laws of Malawi and many other countries are obscure and difficult to be grasped by the majority of taxpayers. It can also be argued that this lack of clearness results in much error and unintentional irregularities on the part of taxpayers. It also dwindles trustworthiness and reverence for the underlying tax law as well as inclines to differentiate against the uninformed and the underprivileged who do not have the ability to take benefit of the available tax planning prospects to the sophisticated and the well-off citizens.

As per Iwuji (2003), the government has the role of providing a conducive tax atmosphere as well as appropriate social services which support the smaller entities. This, for the case of Malawi, for example, implies improving the climate of investment for improved economic development and ensuing contribution of tax from taxpayers which is essential because many SMEs function outside the formal economy because they believe that the tax atmosphere where these SMEs operate is not favorable to their long-term survival. Such SMEs constitute unexploited revenue prospect as well as an unfair tax playing ground in several countries (International Tax Dialogue, 2007; Kintu et al 2019), It can be stated that tax legislation is important to regulate and protect the business atmosphere and secure all economic agents to establish needed social security principles while it concurrently obstructs the SME businesses with more expenses and administrative hindrances, which at the end of the day puts SMEs in worse off situation. It can be argued that unlike for SMEs, large entities can easily hire experts to work on their tax matters. Per Smatrakalev (2006), for SMEs, “this is a big expectation as it results into a huge cost out of their abilities” (Shahroodi 2010

To improve the tax base in terms of tax collection, there is need by the MRA to carryout awareness campaign on the taxation law so that the SMEs are aware of what is expected of them in terms tax law. In line with the “attribution philosophy”, a “greater level of education can proliferate the level of taxpayer facts concerning the system of tax. It can be stated that a highly educated taxpayer should know more to do with the tax laws as well as other fiscal issues. Such an educated person will also be aware of the assistance of government services to its people (Ross & McGee, 2018). Nevertheless, such taxpayers may be critical concerning how the collected tax is being distributed” (Ross & McGee, 2018). This is despite the fact that highly educated persons are in a position to have more sophisticated ways of tax evasion as well as tax avoidance (Torgler & Schneider, 2007). Studies, however, show that an “advanced tax educational level looks to remain a single key tax morale decreasing feature (LagoPenas 2010, p. 22). Marital status may impact illegitimate and legitimate behavior, dependent on the degree to which persons are forced by their community linkages to behave in a certain manner (Tittle, 1980). For example, people who are married, in contrast with those who are not, are more tax obedient; this is because they are significantly constrained by their societal networks. It may therefore be stated that taxpayers who are married have a higher morale of tax than other persons (Torgler, 2006). Ali, Fjeldstad & Sjursen (2015) acknowledges that tax awareness of taxpayers relating to the nature and amount of various taxes to remit to tax establishments has an effect on income tax compliance attitude. Knowledge of tax was therefore measured as an answer of the degree of effort to have a proper understanding relating to the nature of tax to remit to the tax authorities". Responses ranged from one = "very easy" to four = "very difficult". Besides, a mock variable for the need to pay VAT was included. This variable was created from replies to this enquiry: "Regardless of whether you are able to pay, are you required to pay value added tax on the foods and the goods that you buy from shops or traders?" The variable had one to mean respondents that stated that they remained obligated to remit the said tax and zero to mean that they are not obligated to pay. This type of question captures a key feature of the tax knowledge level of respondents because Value Added Tax is common and pervasive and all the respondents must come across it on a frequent basis in this country.

Another study conducted by Ali, Fjeldstad, and Sjursen (2015) has revealed that tax knowledge is significantly linked to a tax-compliant attitude, particularly in South Africa and Tanzania. In these countries, an increase of one point in the perceived difficulty of determining the types of taxes to pay results in an 8% and 5% reduction in the probability of maintaining a tax-compliant attitude, respectively. This means that due to a lack of appropriate tax knowledge, the percentage of people with a tax-compliant attitude, which currently stands at 57% in South Africa and 54% in Tanzania, could be reduced to nearly 51% in both countries.

In the nations above, mock variable on apparent necessity to remit VAT showed a big and statistically important outcome on the taxation compliance likelihood.

4.6.1.1 - Q5. What is the relationship between perceived levels of income tax compliance and the sales made by SMEs?

The results indicated that income tax compliance level is related to SME sales (Chi-square test, p-value = 0.000, Table 39). Overall, 25.3% of SMEs agreed that their sales were high enough for their tax compliance level (table 39). Amongst the never compliant group, 10.24% stated that their sales were high enough while for the partially compliant category, this figure was 17.95%. Amongst the fully compliant group, 43.72% agreed that their sales were high enough for their income tax compliance level (table 40). Comparing these three categories of income tax compliance level, the results indicate an increase in sales with increasing income tax compliance level, with non-compliant tax payers showing lower sales than compliant tax-payers. Overall, it was found that income tax compliance results into increased sales of SMEs. This result is in disagreement with the few studies which have been done locally to explain why tax compliance was generally very low. These local studies found that tax payers considered that the tax paid impacted negatively to the growth of their SME entities. Money which could have been used to grow their SMEs was instead paid to the tax man. SMEs also considered tax rates to be too high, such that they forced a number of SMEs to hide under-ground, away from being taxed, just to avoid giving money to the Revenue Authority" (Chipeta 2002, Chiumia and Simwaka 2012). Elsewhere on the continent and beyond, studies noted "a significant negative relationship between corporate income tax payment and SME financial performance" mostly because of similar reasons as were observed locally (Gadzo, Gatsi, and Kportorgbi 2013; Porto & Santoni 2016, Bolboros 2016, Kurawa 2018).

Notwithstanding the impact which tax is capable of making to what Chipeta (2012) termed the Gross Domestic Product (GDP) of our nation Malawi, much is needed to look at the negative effect of tax in relation to short and long-term survival of small and medium sized entities. This is because while SMEs play an important place in moving financial progress in both developed and developing nations, there is overwhelming evidence that SMEs have a relatively short life span in Malawi of, on average, 5 years (Chipeta 2012).

4.6.1.6 - Q6. What is the relationship between perceived levels of income tax compliance and profitability of SMEs?

The results indicate that income tax compliance level is related to SME profitability (Chi-square test, p-value = 0.000, Table 41). Overall, 23.9% of SMEs agreed that their level of profit was high enough for their tax compliance level (table 42). Amongst the never compliant group, 14% agreed that their profitability was high enough and the same percentage of 14% was noted for the partially compliant category. Amongst the fully compliant group, 70% agreed that their profitability was high enough for their income tax compliance level (table 42). Comparing these three categories of income tax compliance level, the results indicate increasing level of profitability increases with increasing income tax compliance level. Studies by Tee et al (2016), Stumpfegger (2017) and Oladele, et al (2019) noted that llarge proportion of profits made by SMEs are used to pay tax as opposed to expanding their trades. The studies also noted that buying power of SMEs drops soon after taxes are paid. Money which could have been used to buy goods or services for resale and expansion of SMEs is used to pay the Revenue Authority instead, there by resulting into reduced profitability of the same SMEs as opposed to increased profitability as disclosed by the study’s results.

4.6.1.7 - Q7. What is the relationship between tax deterrence instruments/tax morale and income tax compliance level?

Tax deterrence instrument tested were in form of high tax rates imposed by the Malawi Revenue Authority (MRA) to tax non-compliant SMEs, whether these were deterrent enough or not.

Tax morale instruments tested included the following elements: current income tax incentives, if any, given by MRA to tax compliant SMEs; Trust tax payers have in Malawi Government; satisfaction with how the Government spends income tax collected; perceived respect accorded by society and perceived level of tax evasion by other taxpayers in general.

*Perception of ease with which tax payers find to evade income tax versus income tax compliance*

Tax avoidance involves working within the boundaries of the tax law, to reduce tax liability while tax evasion uses illegal means, including declaring less income and claiming more expenses than normal in order to pay less tax.

In general, it was found that 79.47% of tax payers believe that other tax payers find it easy to evade tax (not to pay) in Malawi (table 43). Amongst the never compliant group, 71.08% believe that other tax payers find it easy to evade income tax, followed by the fully compliant ones (70.69%) and lastly the partially compliant (44.87%) (table 44). Comparing these three categories of income tax compliance level, the results suggest increasing belief that tax payers find it easy to evade tax with reducing level of income tax compliance level.

The result is not surprising considering the generally low levels of income tax compliance (40.63%) being observed in this study. Studies have established that the opinion of other folks' tax compliance, is capable of increasing ones' income tax compliance. This agrees with the concept which theorizes that persons "who believe that their fellow citizens comply with taxes are more likely to have a tax compliant attitude" (Ali et al 2013, p.22).

In Malawi, a study by Chipeta (2012) put tax compliance at the rate of 40%. According to Olokooba, Awodun, Akintoye & Adebowale, (2018), the former finance minister of Nigeria stated that the rate of compliance was around 12%, with more than 75% of the enumerated entities in Nigeria "beyond the income tax web; what is even worse is that approximately 65% of those noted to be in the tax net scarcely file any tax returns, neither do they pay any taxes at all". The inference of all this is that tax evasion is widespread not only in Malawi, but on the African continent as a whole. Particularly in Africa, tax evasion is not perceived as a severe crime and tax evaders are often regarded positively, being seen as more intelligent than the average tax payer. However, in a recent study conducted by Michael et al. (2021), it was observed that the perception of tax evasion has shifted. Tax evasion is no longer viewed as positively as in previous studies. Instead, tax avoidance appears to be morally accepted, and taxpayers engaged in tax avoidance are evaluated more favorably than the typical tax payer.

*Ease of Revenue Authority to discover non-compliant tax payers versus income tax compliance*

The study also found that 43.31% of the respondents do not believe that MRA finds it easy to discover tax payers who are not tax compliant and an almost similar number of 42.31% believes that MRA finds it easy to discover tax payers who are not tax compliant (table 45), The belief that MRA finds it easy to discover tax papers who are not tax compliant was found to increase with increasing tax compliance (table 46, Pearson Chi2 = 25.20 Prob = 0.0014).

According to Ortega and Sanguinetti (2013), taxpayers decide as to whether and to what extent must taxes be evaded, using the same way they would approach any risky decision or gamble, that is, by maximizing expected utility. It can be said that using this context, evasion of tax is adversely related to the likelihood of discovery as well as the harshness of the possible penalty. A study by Alkhatib et al. (2018) revealed that "the probability of detection has a significantly negative relationship with income tax evasion. The findings of their study were in agreement with those of other existing empirical literature that also affirmed the significant and negative influence of probability of detection on tax evasion (Abdul-Jabbar, 2009; Almunia and Lopez-Rodriguez, 2018; Ayuba et al., 2016; Bott *et al*., 2017). This result can be attributed to the fact that taxpayers react based on the perception that previous year increase in the sample of businesses audited by tax authority could increase the detection of irregularities in the current year audit.

*Perception of severity of tax penalties from MRA and income tax compliance*

The study also disclosed that the majority of tax payers (75.92%) consider that tax penalties from MRA are usually high and deterrent (punitive enough) (table 48). This belief was seen to increase with reducing income tax compliance level (table 49, Pearson Chi2 = 42.69 Prob = 0.0000) since the ratio grew from 34% to 45% among the fully compliant and never compliant respectively.

This result is however not expected considering the low tax compliance rate disclosed by this study (40.63%). Studies by Almunia et al (2018), Ayuba et al (2016) showed that respondents considered tax penalties to be usually high and deterrent to tax evasion. Other studies have shown that the threat of tax penalties is considered as an important tool for discouraging tax evasion. The above is also in agreement with another study in the state of Palestine which found "a negative correlation between tax penalties and tax evasion, for example, higher tax penalties" resulted into lower tax evasion (Alkhatib et al 2018). This means that although the majority of tax payers evade taxes by not being tax compliance while they at the same time consider that tax penalties are high enough to deter non-tax compliance, they still find greater benefit to evade than to comply, possibly because they believe that it is more difficult for tax authorities to discover tax noncompliance.

A study by Ahangar, Bandpey, & Rokny, (2011) noted a positive relationship between tax rate and tax non-compliance. The results of their study disclosed that an increase in tax rate would lead to an increase in number of tax non-compliance and vice versa. In term of cost of hiring tax agent, it is found out too by Trivedi, Shehata, and Mestelmen (2014) that individual taxpayers are reluctant to engage with tax agent rather than do a self-assessment tax return due to the fact that they feel that it is a waste of money to employ tax agent services. Another research found that smaller entities, especially SMEs and self-employed workers, paid more tax compliance costs than larger entities as a result of the fact that they had to hire tax preparers, as they did not have access to inhouse tax consultants. In reality, SME taxpayers might encounter financial difficulty as a consequence of proportionately higher compliance costs (Isa, 2014) and as a result, their tax compliance levels may be reduced (Arachi, & Santoro, 2007).

*Incentives from MRA for being income tax compliant versus income tax compliance*

A significant minority of 39.41% believe that there aren't good incentives from MRA for firms that are income tax compliant. Only 26.28% agreed (table 51) while the rest (34.31%) remained neutral. This belief was found to increase proportionately with increasing tax compliance level (table 52, Pearson Chi2 = 120.50 Prob = 0.0000)

It is therefore suggested that MRA should consider some form of reward to tax compliant SMEs. The rewards or any form of incentives would certainly improve SMEs perception towards tax compliance which in turn produce positive results such as making more SMEs tax compliant. A study by Tee et al (2016) regarding "incentives for SME development in Ga-West town ship in the city of Accra Ghana found that most SMEs could not benefit from the tax system because they are meant for fully registered SMEs only but even with the registered business very few were aware of such incentives". Indeed, from the above result and the observed p-value of less than 0.001, it can be stated that the rewards or any form of incentives would surely progress SMEs perception towards tax compliance which will in turn result into positive results such as increasing the income tax compliance levels of SMEs. It is suggesting that lack of frequent trainings and mass awareness of incentives regrading income tax compliant SMEs was a key factor in low compliance of income. Lack of incentive scheme coupled with lack of awareness appears to be one of the key factors in observed low tax compliance.

*Trust in Government of Malawi and income tax compliance*

It was observed that most SME tax payers do not have trust in their government. When respondents were asked whether they had trust in the Government of Malawi regarding the management of income tax, 84% of them disagreed while only 12.66% of them agreed (table 53). The level of disagreement was found to increase with increasing tax compliance level (Table 54, Pearson Chi2 = 30.45 Prob = 0.0002)

Studies have shown that where there is low trust in Government, citizens display lower income tax compliance. In Tanzania and Uganda, an Afro Barometer study by Ali et al noted a positive link between trust in Government and income tax compliance. Thus, trust in Government resulted into more income tax compliance and vice versa. In agreement with Ali et al, trust building may not be an alternative for income tax administration, but a supplement. This statement is in accordance with research findings that emphasize the political benefits of cracking down on illegal tax evasion and establishing clear links between new revenue collection and public services. For example, in Colombia, the government initially faced challenges in gaining support from the elite for an income tax increase. However, they successfully secured political backing and increased compliance by allocating the income tax revenue to security spending, which was a top priority for income tax payers.

Furthermore, as outlined by Batrancea et al. (2020), the slippery slope framework of tax compliance underscores the crucial role of trust in authorities as a significant determinant of tax compliance. This trust, in conjunction with traditional enforcement tools such as audits and fines, plays a vital role in influencing individuals' tax compliance intentions and discouraging tax evasion. The study by Batrancea et al. (2020) involved data from an experimental scenario study conducted in 44 nations across five continents, with a total sample size of 14,509 participants. The research findings revealed that trust in authorities and the authority's influence, as defined within the slippery slope framework, increased intentions for tax compliance and reduced intentions for tax evasion across diverse societies with varying economic, sociodemographic, political, and cultural backgrounds.

The study also showed that trust and power fostered compliance through different channels: trusted authorities (those perceived as benevolent and enhancing the common good) registered the highest voluntary compliance, while powerful authorities (those perceived as effectively controlling evasion) registered the highest enforced compliance. In contrast to some previous studies, the results suggest that trust and power are not fully complementary, as indicated by a negative interaction effect. Despite some between-country variations, trust and power are identified as important determinants of tax compliance as Batrancea et al (2020) puts it, all over the world". The results have strong inferences for decision makers all over the world who need to select best practices regarding income tax compliance. It can be stated that lack of trust in the way the Government uses tax payer's money has a negative impact on tax compliance.

Social capital takes a pronounced consequence on tax morale. An investigation by Torgler (2003) regarding the relationship between "trust and tax morale" obtained data from 20 developing nations, covering the years 1990-1999. Confidence in a government as well as confidence in a legitimate structure were noted to be important and positively related. It is said that Spirituality and religion may prevent evasive behavior as they are said to have a sanctioning system in itself that legitimizes and supports social values" (Hirschi et al, 1969). Torgler (2006), also, "expounds on a notion of religiosity as a feature which impacts on tax morale". This was originated "on survey questions which measure attendance at church, religious teaching, church involvement, and significance of religious conviction, religious leadership associated with good and evil and trust in the church" (p. 22) as an entity. According to Torgler, 2006, all these "fundamentals are established to take a substantial positive effect on the morale of tax". Literature of Criminology has also conveyed an adverse relationship between religiosity and crime (Torgler & Schneider, 2007). For example, as religious beliefs decline the level of criminal activity, tax morale increases.

*Satisfaction with the perception of how the Government spend the tax money and income tax compliance*

The findings indicate that a significant proportion of taxpayers, specifically 88.46%, are dissatisfied with how they perceive their government spends the income tax they contribute. When respondents were asked about their satisfaction with the government's utilization of the taxes they pay, the majority (88.46%) disagreed with the government's spending practices, while only 9.25% agreed. Notably, the degree of disagreement was observed to increase with a decreasing level of tax compliance, as indicated in Table 56, with a Pearson Chi2 value of 26.17 and a probability value of 0.0010.

A study conducted by Ali, Fjeldstad, and Sjursen (2013) discovered that in Tanzania, as many as 16% of respondents identified poor public services as the primary reason for tax evasion. Corresponding percentages for South Africa, Uganda, and Kenya were 12%, 11%, and 9%, respectively. The same study also revealed that in Tanzania and Uganda, individuals who expressed higher satisfaction with the government's provision of basic health services and educational needs were more likely to exhibit a compliant attitude, with increases of 9% and 6%, respectively.

As suggested by Wilson et al. (2019), reciprocity is a fundamental element underpinning trust in tax systems and forms the core of the fiscal contract. It hinges on the idea that tax revenues contribute to the provision of valued public goods and services. Many government outreach and educational campaigns stress the importance of taxes in funding national development. The crucial issue for governments is whether taxpayers genuinely believe that their taxes are being used for national development and, if not, how to establish greater trust.

In line with the findings of this study, surveys conducted across the developing world imply that taxpayers, at least in principle, strongly believe in the significance of taxation for government funding and are more likely to comply with income tax if they believe their contributions are put to good use. For instance, the Afrobarometer survey found that, on average, two-thirds of respondents believe that citizens should pay taxes to support national development, even in areas with poor service delivery. A recent survey in the Democratic Republic of Congo also indicated that over 70% of respondents support taxation to fund national development. The empirical evidence clearly demonstrates broad support for effective taxation. However, the lacking belief among taxpayers that their contributions are effectively utilized by their governments leads to reduced tax compliance. It can be stated that a lack of trust in how the government spends taxpayers' money is a significant factor in this regard.

*Level of satisfaction with the goods and services being offered by their government and income tax compliance*

Respondents were also asked whether they were satisfied with the goods and services being offered by their government. The majority of them (83.21% disagreed and only 9.74% of them agreed. The level of disagreement was found to increase with increasing level of tax compliance (table 58, Pearson Chi2 = 38.24 Prob = 0.0000)

A study by Ali et al (2015) centered on “the attitude of Citizens towards tax” which was carried out in Uganda, Kenya, Tanzania and South Africa, a minority of variables were comprised in the analysis of regression to obtain the taxpayers’ contentment with provision of various services and goods which citizens required from the Government. This study included contentment with government’s delivery of community goods like Agriculture, internal security, educational and health services; structures, like government provision of sanitation and water amenities, infrastructures maintenance as well as bridges, and delivery of dependable electricity energy; management of criminal activities by the Government, internal conflict, internal and external terrorism and corrupt activities; level of contentment with how easy it is to obtain simple services from the Government like drivers permits, national identification cards, domestic services as well as police services. Selected sampled respondents were requested to rank their level of contentment with delivery of such services and goods stretching from 1= “very badly” to 4= “very well”. In some rare cases where “respondents stated that they neither know nor have they ever heard of these services, these were subsequently left out of the sample. The study formulated an index for a taxpayer’s contentment with the provision by the Government of such public goods and services” which ranged from “1 to 4”. Upper values meant persons were highly contented with delivery of different amenities by their respective Governments. The study used insights “of other people’s tax compliance as a proxy to measure the influence of other people’s behavior on tax compliance attitude. The variables were measured in form of a reply which took 1 as to mean that respondent thought other taxpayers never avoided taxes, and 5 to mean that they thought other taxpayers always avoided. Higher values denoted taxpayer’s opinion that the other taxpayers are not tax compliant.

Results of the Ali, Fjeldstad and Sjursen (2015) study in the East African countries of Tanzania and Uganda found that “participants that are happy in the way their country is providing health and learning services have a more compliant attitude of 6% and 9%, respectively” (p. 87). In Kenya, participants who are happy with the way the Government is providing roads and educational services have compliance outlook of 11%. In the Republic of South Africa, taxpayers that are happy in the way their country offers various services like dispensing of identity cards as well as receiving household and policing services had a tax compliant outlook of 17%. The above results which came from the 4 nations propose that national expenses can inspire tax obedience, suggesting that the nations can cultivate a tax compliant attitude by offering services which residents require in an effective and manageable manner (Tilly 1992; Moore 2004). The outcomes in these countries showed that each country required diverse goods to motivate its citizens to observe their tax regime.

Ali, Fjeldstad and Sjursen (2015) suggests that the degree to which persons believe “that their own ethnic group is treated unfairly is also significantly correlated with compliant attitude in South Africa and Tanzania” (p. 5). As the extent to which individuals think that their own ethnic group is treated unfairly increases by one point, the probability of having a tax compliant attitude decreases by 6% both in South Africa and Tanzania (Ali, Fjeldstad & Sjursen 2015, p. 5). It can be argued that this provides support for the comparative treatment model, which is based on equity theory and suggests that addressing inequities in the exchange relationship between government and taxpayers matters for tax compliance (Persson 2008; Rothstein and, 2008). Nevertheless, this association appeared not to be present in Uganda and Kenya because this study failed to create any substantial outcome. In Tanzania, a rise in the level of approval of the general presentation of political figures was found to surge the likelihood of taking a compliant outlook" by more than 3%.

A study from Ortega and Sanguinetti (2013) tracked the "tax compliance of local businesses amounting to over 6,000 companies of a key city of Caracas, which was haphazardly allocated to a control of no stimulus, or to one of five treatment arms that received letters from the local tax administrator with different types of messages regarding tax compliance. The study found that "implementing communication that escalates likelihood of discovery had the biggest effect of compliance, a communication relating to provision of the public services and goods given by their country and which affect businesses directly, has the next biggest impact while other messages have greatly lesser effects to compliance" (Ortega & Sanguinetti 2013). Over and above, it was observed that the reciprocity communication appeared to have more permanent impact in comparison to the enforcement communication.

Generally, the findings above appear to offer backing for both the reciprocity and deterrence hypotheses relating to compliance of tax, and, according to the findings of Ortega and Sanguinetti (2013), increased implementation and made:

*How society regards the tax payer in society versus income tax compliance*

When respondents were asked about whether they consider themselves highly regarded/respected in their society versus, the majority of them (77.56%) agreed that they were highly regarded. Only 10.25% disagreed. The impact on tax compliance between compliant and non-compliant SMEs was found to be mixed (table 61, Pearson Chi2 = 29.02 Prob = 0.0003).

Cummings et al. (2009) and Halla (2012), tax payers who are regarded highly in society have a reputation of high-income tax compliance and reduced tax evasion. Considering the relatively low-income tax compliance of 40.63% observed in this study, it can be said that the above result where only the majority (77.56%) believe are highly respected in society unexpected. This is surprising considering the computed low-income tax compliance in this study.

*Perception of widespread income tax evasion versus tax compliance*

It was also noted that many tax payers consider tax evasion to be widespread in Malawi. When respondents were asked about whether they consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi, 80.24% of them agreed that it was and only 10.73% of them believed that it wasn't. This belief of widespread tax evasion was found to increase with decreasing level of tax compliance (Tax 65, Pearson Chi2 = 84.22 Prob = 0.0000)

This kind of belief among the SMEs should encourage those in authority to put in place mechanisms that can help in finding a solution to this problem. This result is in tandem with the low-income tax compliance observed in this study above. A number of findings from researchers found that where income tax evasion is considered wide spread, it results in overall low tax compliance. For example, a study by Doerrenberg et al (2018) found that where "social norms of tax-compliance behavior particularly depend on the perception about the prevalence of tax evasion in society. SME tax payers may be interested to evade taxes when they are of the opinion that tax circumvention is prevalent and may be more obedient when they are of the belief that many of their fellow taxpayers are tax compliant".

4.6.1.8 - Q8. What is the relationship between moderating variables (age, gender, level of education and SME size) and income tax compliance level?

Moderating variables identified by this study included age, gender, level of education of SME respondents as well as relative size of SMEs. These were considered in light of their perceptions on the impact of SME income tax compliance.

*Age of respondents and income tax compliance*

The age categories of respondents of the study are analyzed in table 71. According to the results, the majority of the respondents (61.26) were aged below 40 years (youth age-group) while 38.74% were aged above 40 years (old age category).

The study analyzed the age of respondents relative to income tax compliance. According to the findings, 44% of the youth were never compliant against 34.38% of the old. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing age, with 36.25% for the young and 47.5% for the old (Table 72 Pearson Chi2 = 5.49 Prob = 0.0643).

According to Table 72, income tax compliance is shown to increase with increasing age. The result in Table 72 is in agreement with studies done earlier on. Demographic factors, According to Toggle (2006), “have a significant effect on tax morale”. The number one variable is age of a taxpayer. In general, “youthful taxpayers fear less about possible tax audits and any possible penalties (Sistema, Thomas, & Ferrier, 2003). Hence, increasing age of taxpayers appears to have an affirmative impact on the morale of tax (Torgler 2006). Subsequent to analyzing gender variable, Societal researchers suggest that females comply more, besides, are lesser self-contained than males (Tittle, 1980). Conventionally, women are known with conforming roles, moral restraints and more conservative life patterns” (Jackson & Milliron, 2016).

The above result contradicts with a recent study done by Defitri1 et al (2018). This study surveyed the “effects of demographic factors (age and education) and e-filling usage on tax compliance. The research design adopted in this study was the survey and sample selection were done by purposive sampling method. Data collection was done by distributing questionnaires and samples of 90 taxpayers. Multiple regression was used to test the hypotheses. From the analysis of results, it was found that demographic factors (age and education) and e-filling” usage have no effect on tax compliance.

*Gender and Income tax compliance level*

The research survey finding revealed that 57.14% of the respondents were males while 42.86% were females (Table 66). This clearly shows that males dominated the operations of SMEs in Malawi.

The study also disclosed an overall higher non-compliance in females than in males as 42.94% of females never paid income tax against 38.46% of their male counterparts (table 67). When full compliance is considered, the 36.13 were found to be fully compliant for females against 44.02% for their male counterparts. (Table 67, Pearson Chi2 = 2.64 Prob = 0.2672)

The study also had more youthful females in comparison to males as 67.23% of the females were in the young category against 56.78% of their male counterparts (table 68).

It can therefore be concluded from this result that males comply more in comparison to females. This result contradicts studies carried out in developed nations. D’Attoma et al (2017) carried out a cross country experiment in America, the United Kingdom, Italy and Sweden. Results of this study disclosed that women are considerably more income tax compliant than their respective men under all conditions and in all countries where the study was done. Another study by Yimam and Asmare (2020) observed that in emerging nations where females are greatly marginalized and victimized in all material aspects, studies intended to investigate the aim of the behavioral variance in tax mobilization disclosed that business entities held by a women-majority were more income tax compliant than the ones owned by male-majority. The outcome of this study also showed that the likelihood of being income tax compliant rises when the share ownership of female owned businesses increases. Yimam and Asmare (2020) study also showed that where female ownership was 100 percent, there was a higher chance of more than 24 percent of being income tax compliant than where such ownership was 100 percent in the hands of their male counterparts. Another study by Aladejebi (2018) titled "the level of tax compliance among owners of small and medium enterprises (SMEs) in Nigeria disclosed that female SME owners were more tax compliant than male counterparts. This study, suggests that, polices, rules and regulations meant to improve tax administration system, introduction of new income tax implementation as well as tax audits should all take into account differences in behavior between female and male ownership". As Yimam and Asmare (2020) puts it "it is also necessary to improve women business participation in the country for equity concerns just as such participation will result in curtailing income tax evasion. This study recommended special tax payer education amongst owners of SMEs". The study also found out that Tax amnesty increased the level of voluntary income tax compliance.

*Level of education and income tax compliance*

According to the findings, 44.79% of the respondents were secondary school graduates; 28.09% had college diplomas, 19.61% of the respondents were holders of undergraduate degrees and 1.21% of respondents had Masters Degrees. The study also revealed that 0.24% of respondents (one respondents) had Doctorate degrees (Table 69).

The study analyzed the academic qualifications relative to income tax compliance. According to the findings, 60% of the primary school dropouts were never compliant. This percentage reduces to 44.26% for Secondary School leavers and 37.93% for diploma holders, 29.63% for undergraduate degree holders and, 20% for Master's degree holders and 0% for PhD holder. Income tax non-compliance is seen to decrease with increasing level of education. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing level of education (Table 70 Pearson Chi2 = 25.62 Prob = 0.0043).

It can be seen from the results that income tax compliance increased with increasing education. This is in line with a number of studies done within and beyond the continent. For example, s study by Gitaru (2020) whose aim was to "assess the effect of taxpayer education on tax compliance in Kenya, the case of SMEs in Nairobi CBD established a clear relationship between education of taxpayers using media such as electronic, print and direct engagement of stake holders. The study population involved SMEs in Nairobi Central Business District (CBD). The data for this study was collected through the administration of pretested questionnaires to small and medium-sized enterprise (SME) owners. To analyze the data, a combination of descriptive and inferential statistics was employed. Questionnaires were used to collect nominal and ordinal data, and this data was subsequently quantitatively analyzed using the Statistical Software for Data Science (STATA). The results were presented in the form of frequency distribution tables and graphs.

The study's findings indicated that electronic taxpayer education, print media taxpayer education, and stakeholder engagement have an impact on tax compliance among SMEs in the Central Business District (CBD) area of Nairobi. To establish the relationships between the independent variables, a correlation matrix was created. It was observed that stakeholder sensitization is positively correlated with taxpayers' education on the correct calculation of income tax, as indicated by a correlation coefficient of 0.810. As a recommendation, the study suggested need to encourage tax payer education in order to improve income tax compliance. In the words of Gitaru (2020), "for SMEs to improve their tax compliances, those involved in their tax matters need knowledge and skills to interpret the various tax laws and regulations. Tax compliance procedures should be simplified because in most cases they are found to be very complicated by SMEs, especially for those who do not keep proper books of account and sometimes do not understand the tax laws in order to reduce the compliance costs in terms of money and time". Gitaru (2020) also suggests reduced tax rates made specific for SME entities, together with increased income tax incentives and some specific tax exemptions.

Another desk study by Newman et al (2018) with the aim of evaluating "the impact of tax knowledge on tax compliance among small and medium enterprises (SMEs) in a developing country" interrogated literature so as to ascertain if SMEs in the developing country under study possessed tax knowledge and also to identify the possible elements that constitute tax knowledge among SMEs. Other factors that could be influencing noncompliance among SMEs were identified as well as methods which could be adopted by tax Authority to increase awareness and compliance SMEs. The study established that SMEs in this particular developing country do not comply with tax law. They possess only basic tax knowledge and lack a deeper understanding of tax issues. It also emerged that enhancing tax knowledge on its own without addressing the high tax rates and corruption will not positively impact on tax compliance behavior among SMEs. This study recommended a preliminary income tax course to be introduced in institutions of higher learning, may be as an optional topic "so that students are aware of their responsibilities as future taxpayers.

A study in Indonesia by Inasius (2019) examined "factors influencing the tax compliance of small-and medium-sized enterprises (SMEs) for income-tax reporting requirements in Indonesia". The study used multiple regressions and examined six income tax compliance aspects. Data collection was done using a questionnaire survey which was conducted in Jakarta on a sample size of 328 SME business owners. Inasius (2019) employed a "researcher–administered questionnaire survey method for data collection. The results revealed that referral groups, the probability of audit, tax knowledge, and the perception of equity and fairness have a significant impact on tax compliance. In particular, the referral group had the most significant influence on the noncompliance behavior of SME taxpayers". The findings had the potential of enabling tax policymakers to come up with appropriate prospective tax policies which focus on income tax compliance of SMEs. The study also made contribution to literature by adding tax compliance observations from the Asian nations.

Specific education, especially in tax is important as it may assist them to comprehend tax laws and principles better. A study by Osebe (2013) emphasized that education in general allows taxpayers to comprehend the system of tax and to be conversant of the tax responsibilities. Further studies done in Malaysia by Damajanti, & Karim, (2017) also advised tax acquaintance to be "the most influential factor to determine taxpayers' compliance behavior under the self-assessment system".

Another research carried out by Machogu, & Amayi, (2013) noted that taxpayers knowledge influenced their result regarding their compliance, 83% of the research respondents stated that their knowledge of tax helped them to appreciate the tax processes. Sanusi (2019) supposed that lack of tax knowledge amongst tax-payers could results into acts of misbehavior and unintended tax circumvention ultimately. However, tax is taken as one of the subjects that can be said to be difficult and complicated to master. As per CIAT, (2011). “Countries with high level of tax compliance such as Canada, the United States, Switzerland, and New Zealand had included tax development programs to prepare students for adult life at the early stage of education”. This demonstrated the importance of knowledge, especially, tax knowledge.

*SME size and income tax compliance*

Respondents of the research were asked to indicate their size in employee number terms. According to the findings, 52.54% of the entities sampled were considered as small while 47.46% were considered as medium.

The study analyzed the SME size relative to income tax compliance. According to the findings, 59.72% of the small entities were never compliant against 18.97% of the medium ones. The trend for the fully compliant category is opposite to that of the never compliant category as it increases with increasing SME size, with 29.17% for the small and 53.33% for the medium (Table 75 Pearson Chi2 = 71.71 Prob = 0.0000).

### 4.7 Chapter summary

The chapter provided an outline and purpose of this quantitative research study. The chapter then summarised reliability and validity grounds of data, results of research findings together with related graphical illustrations, and then finally, the findings were evaluated in detail. The presentation and discussion of the research findings was guided by the research questions. Quantitative data was presented in table form and graphs.

STATA version 18 was used to analyse the collected quantitative data. The discussion of the findings was done in light of the literature review discussed in chapter 2 of this document.

The study followed the quantitative method approach because the research instrument captured perceptions of SMEs regarding their level of sales and the impact of their income tax compliance on their sales and profitability, on a 5 point likert scale. The study also found out if a relationship exists between two identified variables of interest: perceived level of income tax compliance on one hand and the impact such perceived level of income tax compliance has on financial performance in terms of sales and profitability. Data was obtained through perceptions in form of numbers, on a 5 point likert scale. These numbers were subsequently captured, cleaned and analyzed using descriptive statistics, through a statistical package, STATA.

Out of the 413 SMEs, the level of full compliance was found to be at the rate of 40.63%, 18.9% were partially compliant and 40.39% were fully non-compliant. The resultant low-income tax compliance was attributed to a number of factors. Some of the factors, include: first, poor implementation of general tax deterrence elements and related behavioral aspects (e.g., tax morale). Second, SMEs found income tax rates to be too high; third SMEs found the tax system unfair; Fourth, SMEs did not believe that other taxpayers are faithful in their payment of tax; fifth, SMEs believed that other tax payers find it easy to evade tax: Sixth, SMEs believed that it is not easy for the Malawi Revenue Authority (MRA) to discover tax non-compliance. Seventh, SMEs believed that tax penalties are not high enough to act as a deterrence against tax non-compliance; and, SMEs were of the opinion that MRA does not provide good tax payer education to them.

Further, SMEs indicated a number of additional reasons why they were not motivated to pay their income taxes.  First, they indicated that they had no trust in their government; Second, they were not contented with the manner their government spent their taxes; thirdly, they considered that income tax evasion is widespread in Malawi; fourthly, they believed that the Malawi income tax system places a heavy burden on SMEs as compared to larger entities; fifth, they consider their businesses are too small to comply with income tax; sixth, they don’t understand what the Revenue Authority does with the income tax money collected; Income tax rates are too high; The process of registration is long. Other reasons given included difficulty in interpreting ambiguous and complex tax regulations and laws; Lack of resources or expertise in-house; Keeping up with frequent tax law changes; technology or software-related challenges; difficulty in calculating accurate income tax deductions and credits; difficulty in gathering and organizing necessary financial documents and difficulty in ensuring timely and accurate filing and payment of taxes; dealing with audits or tax disputes; navigating complex reporting requirements and difficulty in managing multiple tax obligations.

Regarding what needs to be done in order to surmount the observed challenges, the majority of respondents stated that they wished the Malawi Revenue Authority (MRA) provided special tax training to SME's; MRA should simplify the tax law for the understanding of everyone; MRA should reduce the income tax rate on small businesses; Taxpayers should consider obtaining advice from professionals like Accountants and auditors; no idea and the need for taxpayers to keep accurate records (0.24%) (table 38).

The study also found that income tax compliance resulted into increased sales, not in agreement with studies elsewhere in Africa which noted a significant negative relationship between corporate income tax compliance and overall SME financial performance. The study also noted that the buying power of SMEs dropped soon after taxes are paid.

This is overwhelming evidence why SME's may not be motivated to comply fully with income tax laws.

The subsequent chapter moves to implications, conclusions and related recommendations which brings to the end of this study.

# Chapter 5: Implications, Recommendations and Conclusions

## 5.0 Introduction

This last section is a discussion of implications, limitations, recommendations and conclusions under six sections. The first section is an explanation of the main objectives of this study, the motivation for the study as well as the ethical matters of the study. The second section is a summary of findings of the perceived level of income tax in Malawi, followed by the impact such income tax compliance has on sales and on profitability of these small and medium entities. The third section is a summary of research implications. Section four discusses limitations of the study while the fifth section discusses contribution to knowledge before finally giving an overall summary to the chapter.

## 5.1 Summary of findings

The presentation of the summary is guided by the research objectives. The main objectives of the study are to find SME perceptions of the income tax compliance level as well as the impact which such perceived level of income tax compliance has on financial performance of Small and Medium Sized Entities in Malawi, for the financial year ended 31 December 2022. The study found out whether SMEs in Malawi pay income tax and whether they pay fully, partially or not at all. Additionally, the study also assessed the impact such perceived level of income tax compliance has on the financial performance of SMEs. Financial performance was measured by a perception of level of sales and level of profitability.

It was found that the majority of taxpayers do not find the current income tax system fair on SMEs; are not affected in their decision making by their (low) current tax compliance level; are not knowledgeable of the current income tax rate and face numerous challenges when trying to comply with the income tax regime.

It was also found that out of the 413 SMEs, the level of full compliance was found to be at the rate of 40.63%, 18.9% were partially compliant and 40.39% were fully non-compliant.

The resultant low-income tax compliance was attributed to a number of factors. Some of the factors, include: first, poor implementation of general tax deterrence elements and related behavioral aspects (e.g., tax morale). Second, SMEs found income tax rates to be too high; third SMEs found the tax system unfair; Fourth, SMEs did not believe that other taxpayers are faithful in their payment of tax; fifth, SMEs believed that other tax payers find it easy to evade tax: Sixth, SMEs believed that it is not easy for the Malawi Revenue Authority (MRA) to discover tax non-compliance. Seventh, SMEs believed that tax penalties are not high enough to act as a deterrence against tax non-compliance; and, SMEs were of the opinion that MRA does not provide good tax payer education to them.

Further, SMEs indicated a number of additional reasons why they were not motivated to participate in their income tax compliance. First, they indicated that they had no trust in their government; Second, they were not contented with the manner their government spent their taxes; thirdly, they considered that income tax evasion is widespread in Malawi; fourthly, they believed that the Malawi income tax system places a heavy burden on SMEs as compared to larger entities; The study also found that income tax compliance resulted into reduced sales, in agreement with studies elsewhere in Africa which noted a significant negative relationship existed between corporate income tax compliance and overall SME financial performance. The study also noted that the buying power of SMEs dropped soon after taxes are paid.

The motivation to carry out this study was because the researcher owns three enterprises which are in the category of small and medium enterprises and income tax forms an important component of the SME entities. Besides, tax in general and income tax in particular forms a vital source of revenue for the national revenue, yet there are very few studies in the country in the area of tax in general despite their importance. Besides, SMEs are considered as a major industry in Malawi and hence a vital source of revenue for the Malawi Revenue Authority.

This study was approved by Unicaf University's Research Ethics Committee (UREC) before data was collected. Participants were first told verbally as well as in writing regarding the demands and nature of this study. The participants provided their written consent and offered to take part in this study after approval of Unicaf University's Research Ethics Committee in line with Helsinki Declaration.

## 5.2 Perceptions of fairness of current income tax system on SMEs, level of SME income tax compliance

It was found that the majority of taxpayers (88.35%) do not find the current income tax system fair on SMEs.

The study also found that the level of income tax compliance in Malawi was low. SMEs income tax compliance was found to be at the rate of 40.63%. The study adopted Bătrâncea et al 2012 tax compliance definition which requires the following four principles to be true if an entity is said to be tax compliant: “accurate income tax basis need to be used; correct income tax computation need to be made; the tax return need to be done within the stipulated filing period and finally, correct assessed amount need to be paid within the stipulated time. Following this definition, 40.63% of SMEs were found to be income tax compliant while 18.9% of them were found to be partially compliant and 7.7% were found to be never compliant.

This very low-income tax compliance was found to be from poor implementation by the Malawi Revenue Authority of general tax deterrence elements and behavioral aspects (tax morale) of income tax compliance called Tax morale. The study examined SME income tax compliance from the following two commonly used tax enforcement tools: general tax deterrence, commonly named as the economic method and a wider behavioral method called Tax morale (Frey, 2002; Tusubira and Nkote, 2013; Ritsatos, 2014; Chauke & Sebola 2016; Mardhiah et al. 2019). Tax morale is “the intrinsic motivation of why people pay taxes” or “a moral obligation to pay taxes” or “a belief in contributing to society by paying taxes” (Torgler & Schneider, 2009; Cummings et al., 2009; Halla, 2012). It combines the “social and fiscal psychological theories” (Frey & Feld, 2002; Chauke & Sebola 2016).

Regarding general tax deterrence elements as income tax compliance tools, the study found that SMEs regard the current income tax rates on taxable profits being implemented by the Revenue Authority to be too high. The study also found that SMEs find the current tax system to be unfavorable to SMEs and favorable to large entities instead. SME tax payers do not believe that other tax payers are faithful in their payment of tax, do not believe that other tax payers find it easy to evade tax, do not believe that it is easy for MRA to discover non-compliant tax payers, do not believe that current tax penalties are high enough to act as a deterrent against non-compliance and are of the opinion that MRA does not provide good tax payer education to SMEs in Malawi, there by resulting into general non-compliance with the income tax regime.

Regarding behavioral aspects of tax compliance (tax morale), the study found that SMEs do not have trust in the Malawi Government, are not contented with the manner the Government spends their taxes, consider that income tax evasion is widespread in Malawi and believe that the Malawi income tax system places a heavy burden on SMEs as compared to larger entities. The study also found that younger tax payers are less income tax compliant than older ones, smaller SMEs are less income tax compliant than larger ones" and less educated tax payers are less income tax compliant than the more educated ones.

### 5.3 - Effect of perceived income tax compliance on the decision-making process of the SMEs

It was found that the majority (69.83%) of SME tax payers were not affected by their income tax compliance, meaning, there was no effect of the perceived income tax compliance on their decision making. This was mostly because their business evades tax payments and so they are not affected while others specified that they are usually aware of any upcoming tax obligations and hence they plan well in advance. This result is not surprising considering the low overall income tax compliance level observed in this study. It is to be noted that a number of studies found that "taxpayers evade taxes when they are of the belief that tax evasion is prevalent" (Luttmer & Singhal 2014, p. 8). The majority of tax payers stated that their tax compliance status did not affect their decision-making processes simply because approximately 60% of SME tax payers in Malawi are not fully income tax compliant.

Those who stated that their income tax compliance affected their decision-making technics gave the following as the main reasons: taxes make goods and services more expensive; SMEs are charged more, as a result, this affects the growth of the business and because of this, less profit is made; the business fails to employ more personnel because money is used for taxes instead (table 31).

While the majority of respondents (66.83%) were found to be registered for income tax, a significant minority of 33.17% weas not. It was also found that the majority of tax payers (58.74%) were not knowledgeable of the correct income tax rate while 41.26% were (table 33).

The main reasons for not registering for income tax included the following: the business is small, with little working capital hence not ready to pay tax; they don't understand what the Revenue Authority does with the income tax money; Income tax rates are too high; The process of registration is long and the feeling that they haven't reached the income tax registration thresh-hold yet (table 35).

Challenges faced by SMEs when complying with the existing income tax regime and what needs to be done to surmount these challenges

It was found that the main challenges faced by SMEs when complying with the existing income tax regime were as follows: Difficulty in interpreting ambiguous tax guidelines; Understanding complex tax regulations and laws; Lack of resources or expertise in-house; Keeping up with frequent tax law changes; Technology or software-related challenges; Calculating accurate deductions and credits; Gathering and organizing necessary financial documents; Ensuring timely and accurate filing and payment of taxes; Dealing with audits or tax disputes; Navigating complex reporting requirements and managing multiple tax obligations.

Regarding what needs to be done in order to surmount the observed challenges, the majority of respondents stated that they wished the Malawi Revenue Authority (MRA) provided special tax training to SME's; MRA should simplify the tax law for the understanding of everyone; MRA should reduce the income tax rate on small businesses; Taxpayers should consider obtaining advice from professionals like Accountants and auditors and taxpayers should keep accurate records.

## 5.4 Relationship between income tax compliance and sales of SMEs

The study found that compliance with the income tax regime results into overall increased sales. This outcome is not in line with the few studies done locally and beyond. These studies revealed that tax payers found tax rates to be too high, such that they forced a number of SMEs to hide under-ground, away from being taxed, in agreement with results of studies done locally by Chipeta (2002) and Chiumia and Simwaka (2012). The above result is also not in agreement with results of studies done in other parts of the continent and beyond, where studies found a substantial adverse relationship between company income tax compliance and financial performance. (Gadzo, Gatsi, and Kportorgbi 2013; Porto & Santoni 2016, Bolboros 2016 Kurawa 2018). It is stated that “the buying power of an SME declines immediately after-tax payment” (Chipeta 2002, p. 2). Money which could have been used to enhance the growth of an SME is instead paid to the tax authority in form of taxes. This forces many SMEs to hide under-ground, away from being taxed (Chipeta 2002 and Chiumia & Simwaka 2012).

### 5.5 Relationship between income tax compliance and profitability of SMEs

The study found that compliance with the income tax regime resulted into increased profitability. This result is also not in agreement with some studies done on the African continent, like that by Tee et al (2016), Stumpfegger (2017) and Oladele, et al (2019) who observed that the money which could have been used to expand SME business was instead used to pay tax. These earlier studies also noted that the buying power of SMEs dropped soon after taxes were paid. This result is however in agreement with the observation of the Organization of Economic Community Development (OECD) (2012) in developed nations which noted "better tax compliance of SMEs to be proportionately related to their long-term sustainability and growth". Thus, in the developed world, the more SMEs comply with their income tax obligations, the higher the sales and the higher the related profitability. Better tax compliance was not necessarily found to be a panacea to all the problems of SME enterprises, but according to OECD (2012), income tax compliance was found to clearly play a critical role to SME's overall long-term health and performance. According to OECD, the financial performance of SME entities in terms of sales and profitability, benefits more and to a greater extent depends on good compliance with income tax principles. The higher the level of income tax compliance, the better the financial performance in terms of sales and profitability of SMEs and vice-versa (OECD 2012).

### 5.6 Implications

#### 5.6.1 Practical implications

The overall low-income tax compliance of only 40.63% was found to originate from a combination of badly implemented general tax deterrence instruments as well as social aspects of tax compliance. Hence this study is of great significance in guiding the Malawi Revenue Authorities by coming up with appropriate deterrence strategies of improving tax compliance among Malawian SME taxpayers. As per the World Bank study of 2018, SMEs comprise of a significant portion of entities in Malawi and also form an important source of tax revenue for the Malawi Revenue Authority.

Such strategies, which have to be aimed at increasing voluntary tax compliance, should result into the much-needed improved fiscal collection and reduced National budget deficit.

Lack of knowledge of tax law by tax payers will result into less tax compliance as tax payers are confused as to the exact amount of tax to pay and the tax rate to apply. Tax education together with "related knowledge is significantly correlated with tax compliant attitude" (Ali et al 2013, p. 12). SME tax payers are encouraged to educate themselves generally and in tax matters in particular so that they are able to articulate tax matters with relative ease.

### 5.6.2 Policy implications

The finding that SMEs find income tax rates to be exorbitant and end up by resorting to trading under underground, away from the eyes of tax authorities for their survival (Chipeta 2002, Fagbem et al 2010, Chiumia and Simwaka 2012) must be of significance to policy makers. A tax system which is considered as exorbitant, punitive and unfair to tax payers simply inspires SMEs to be tax evasive as SMEs take the tax system "to be a tool by a monster government which is concerned with only increasing the tax collected without any regard to policies considered as fair by the taxpayers" (Lago et al., 2010). A tax system which is considered "complex puts compliance stress on the respective SMEs" (Atawodi et al., 2012). It can be stated that SMEs will feel justified not to comply with the tax regime on account of complexity of the tax system. Hence the policy makers in the area of tax are advised to come up with a tax reduction rate policy which will be found to be reasonable and fair to SME tax payers, thereby spurring voluntary income tax compliance and growth of the SMEs at the same time as more money will be left in the hands of SMEs to spur their growth as opposed to being taken by the Revenue Authority. With time, SMEs would graduate into large entities and would no longer have the feeling that Small and Medium Sized entities find tax systems complicated and place disproportionate pressure on smaller businesses. Small taxpayers under the regular system of taxation are discriminated against, since the compliance requirements, cost of compliance and tax rate are the same for both small and large enterprises" (Atawodi & Ojeka 2012, Olawale and Garwe 2017).

Improving tax morale generally implies improving delivery of goods and services towards taxpayers, hence making them feel appreciated, valued and heard. This is regarded as taking very long to make impact. According to Halla (2018), policy activities which aim at improving the reciprocal trust among SMEs and the Revenue Authorities are ineffective in the short term as tax morale is generally viewed as "very slowly changing" (Halla 2018, p. 12) while "an increase in enforced compliance can be achieved by increasing the standard tools of deterrence, namely audits and penalty" (Prinz, Muehlbacher and Kirchler, 2012, p. 2). There is need to come up with policies which will improve tax morale and at the same time increase trust of SME tax payers in their government. Finally, lack of incentives from the Malawi Revenue Authority to faithful SME tax payer's acts as a demotivation to SMEs. There is need for a deliberate policy of tax incentives to be accorded to faithful SME tax payers. This may take several forms, including some form of tax holiday, reduced rates for subsequent payments and some form of special recognition.

Although this study found that males have a more tax compliant attitude in comparison to females, the finding clearly contradicts studies carried out in developed nations. D'Attoma et al (2017) carried out a cross country experiment in America, the United Kingdom, Italy and Sweden. Results of this study disclosed that women are considerably more income tax compliant than their respective men under all conditions and in all countries where the study was done. Another study by Yimam and Asmare (2020) observed that in emerging nations where females are greatly marginalized and victimized in all material aspects, studies intended to investigate the aim of the behavioral variance in tax mobilization disclosed that business entities held by a women-majority were more income tax compliant than the ones owned by male-majority. Yimam and Asmare (2020) study also showed that where female ownership was 100 percent, there was a higher chance of more than 24 percent of being income tax compliant than where such ownership was 100 percent in the hands of their male counterparts. Another study by Aladejebi (2018) titled the "level of tax compliance among owners of small and medium enterprises (SMEs) in Nigeria" disclosed that female SME owners were more tax compliant than male counterparts. First and foremost, as Yimam and Asmare (2020) recommended, it is "necessary to improve women business participation in the country for equity concerns although, according to this study and due to probable other factors, including observed significant differences in general education between males and females, such participation may not result in curtailing income tax evasion. Conventionally, women are known with conforming roles, moral restraints and more conservative life patterns" (Jackson & Milliron, 2016, p. 12). This study also suggests that "polices, rules and regulations meant to improve tax administration system, introduction of new income tax implementation as well as tax audits should all take into account differences in behavior between female and male ownership. The result of this study as shown under Table 4.48 above, shows that income tax compliance is shown to increase with increasing age of SME owners or managers, in agreement with results of other studies, including that of Toggle (2006), who concluded that “demographics have a significant effect on tax morale. The number one variable is age of a taxpayer. In general, youthful taxpayers fear less about possible tax audits and any possible penalties” (Sistema, Thomas, & Ferrier, 2003, p. 12). Hence, increasing age of taxpayers had an affirmative impact on the morale of tax (Torgler 2006). These results, however, contradicts with a recent study done by Defitri1 et al (2018) who surveyed the effects of demographic factors (age and education) and e-filling usage on tax compliance. From the analysis of results, it was found that demographic factors (age and education) and e-filing practice have no impact on compliance with tax. Never the less, as a policy measure, it is suggested that varying deterrent measures be applied depending on the age group of SME owners or managers, with stiffer measures being applied on youthful ones.

Results from this study have also shown that income tax compliance increased with increasing level of education, in line with a number of studies done within and beyond the continent. For example, s study by Gitaru (2020) whose aim was to assess the effect of taxpayer education on tax compliance in Kenya, the case of SMEs in Nairobi CBD established a clear relationship between education of taxpayers using media such as electronic, print and direct engagement of stake holders. As a recommendation, the study suggests need to encourage tax payer education in order to improve income tax compliance. In the words of Gitaru (2017), for SMEs to “improve their tax compliances, those involved in their tax matters need knowledge and skills to interpret the various tax laws and regulations (p. 37). Tax compliance procedures should be simplified because in most cases they are found to be very complicated by SMEs, especially for those who do not keep proper books of account and sometimes do not understand the tax laws in order to reduce the compliance costs in terms of money and time”.

In summary, the following are the key policy implications for this study.

Tax policy review and reform

Policy implication: The Malawian government should conduct a comprehensive review of its tax policies, especially as they pertain to SMEs, with the aim of simplifying tax structures, reducing tax rates, and thereby enhancing fairness.

Implementation: Establish a dedicated tax policy review committee comprising tax experts, government officials, and SME representatives. The committee should identify specific areas of reform and propose changes to tax laws and regulations accordingly.

Tax education and training program

Policy implication: Implement mandatory tax education and training programs for SMEs, including workshops, seminars, and any locally available online resources, to improve their understanding of tax compliance requirements and incentives.

Implementation: Develop user-friendly, affordable, and secure digital platforms for tax compliance. Provide technical support and training to help SMEs transition to digital tax processes.

Digitalization of tax processes

Policy implication: Introduce sector-specific tax incentives that cater to the unique needs and challenges faced by different SME segments and sizes, such as agriculture, small scale manufacturing, and small-scale technology.

Implementation: Collaborate with industry experts and SME representatives to identify the most effective incentives for each sector and SME size. Ensure transparent and accessible application processes.

Financial support mechanism

Policy implication: Establish financial support mechanisms, including low-interest loans and grants, to assist SMEs in meeting their tax obligations during difficult periods.

Implementation: Partner with some local financial institutions, like banks, to design and offer financial products specifically tailored to SMEs' tax-related cash flow challenges.

Stakeholder engagement platforms

Policy implication: Create regular stakeholder engagement platforms that bring together SME associations, chambers of commerce, tax authorities, and policymakers to facilitate open dialogue and feedback on tax policies and regulations.

Implementation: Organize periodic meetings, forums, and consultations, ensuring that SME voices are heard in the policy-making process.

Enhanced tax enforcement:

Policy implication: Strengthen tax enforcement mechanisms to reduce tax evasion and improve compliance among SMEs.

Implementation: Invest in training and capacity-building for tax inspectors, implement advanced data analytics for tax monitoring, and impose stricter penalties for tax evasion.

Public awareness campaign

Implementation: Utilize various media channels, including television, radio, social media, and community outreach programs, to disseminate information about the benefits of tax compliance and the consequences of evasion.

Implementation: Utilize various media channels, including television, radio, social media, and community outreach programs, to disseminate information about the benefits of tax compliance and the consequences of evasion.

Research and data collection:

Policy implication: Allocate resources for continuous research and data collection to monitor the impact of tax policies on SMEs' financial performance and economic growth.

Implementation: Collaborate with academic institutions, research organizations, and statistical agencies to conduct regular surveys and studies on SME tax compliance and its effects on the broader economy

### 5.6.3 Social implications

The perceptions of Small and Medium-sized Enterprises (SMEs) regarding income tax compliance and its consequences extend beyond the realm of business operations, having profound social implications in the context of Malawi. This section explores these multifaceted social implications, emphasizing how policies and interventions aimed at addressing SMEs' tax compliance perceptions can influence broader societal aspects.

Reduced informality

The informal economy has been a persistent challenge in Malawi, limiting the formalization of businesses and, consequently, depriving workers of labor protections and social benefits. When SMEs perceive a more favorable tax environment and reduced compliance burdens, they are more likely to formalize their operations (Kpodar & Mlachila, 2013). The social impact of this shift is substantial, as it leads to improved labor conditions and increased access to social safety nets for employees within the formal SME sector.

Increased employment opportunity.

SMEs, when unburdened by excessive tax compliance challenges, are better positioned for growth. Consequently, they tend to expand their operations, leading to increased employment opportunities (McKinsey & Company, 2018). This has a direct social implication, as higher employment rates can reduce poverty levels, improve living standards, and contribute to greater economic stability within local communities.

Enhanced entrepreneurial ecosystems

A conducive tax environment for SMEs fosters the growth of a vibrant entrepreneurial ecosystem. When SMEs perceive that they can thrive without excessive tax burdens, they become more likely to engage in innovative activities, knowledge sharing, and skill development. This has far-reaching social implications as it promotes economic diversification, enhances competitiveness, and generates opportunities for individuals to participate in entrepreneurial endeavors.

Reduced income inequalities

Policies that enable SMEs to meet their tax obligations without disproportionately burdening their financial performance can contribute to a more equitable distribution of income within society. Reduced income inequality has a direct social impact by fostering social cohesion, political stability, and a sense of fairness among the populace (Oxfam, 2020).

Improved financial literacy

Tax education programs and capacity-building initiatives aimed at SMEs enhance their financial literacy. Improved financial literacy extends beyond business operations, benefiting individuals in their personal financial decision-making (Lusardi & Mitchell, 2014). This has a social implication as it empowers individuals to make informed financial choices, thereby enhancing their financial well-being.

These social implications highlight the interconnectedness of SME taxation policies, economic development, and societal well-being in the context of Malawi. A favorable tax environment for SMEs can lead to a reduction in informality, increased employment opportunities, a thriving entrepreneurial ecosystem, reduced income inequality, improved financial literacy, and, ultimately, a more equitable and prosperous society. Policymakers and stakeholders should consider these social implications when crafting and implementing policies to address SME perceptions of income tax compliance in Malawi.

## 5.7 Limitations of the study

The study has had some limitations in terms of generalizing of sampled findings, level of analysis and data collection as detailed below:

### 5.7.1 Use of sampling

This research adopted a random sampling technique as a selection frame. As per the world bank report of May, 2022, the 2019 Finscope Micro, Small and Medium Enterprises (MSMEs) estimated that there were about 1.6 million MSMEs in the Malawi which employed about 1.8 million people in total. This report established that approximately 74% (1,184,000) of the enterprises were micro enterprises, 23% (368,000) were small enterprises and only 3% (48,000) were considered as medium enterprises. The report estimated that the Micro, Small and Medium Enterprise sector "contributes about 40% of gross domestic product (GDP) and 24% of employment, and that about 21% of the country's adult population derives their livelihood from the sector". This level of contribution cannot be said to be small.

A representative Taro Yamane (Yamane, 1973) computed sample size of 413 SMEs was selected, from a population of 416,000 profit-oriented SMEs in Malawi.

Simple random sampling was engaged to pick a representative SME industry in Malawi. Random sampling made sure that each SME had the same likelihood of being selected as well as the probability of receiving a reply. The study made use of primary data from the taxpayers relating to the period 1st January 2022 to 31st December 2022. Data collection used online structured questionnaire. The questionnaire was distributed electronically to randomly selected SMEs and responses were received back from interviewees within two weeks of distributing the questionnaire. These steps avoided arbitrary selection and ambiguous responses which can have a negative effect on generalizability of research findings. While findings from this research can be relied on to give income tax compliance views of SMEs in Malawi, however, selection of SME respondents being on a sample basis, there is a possibility of sampling error (Babbie, 2016). This is the possibility that results from a sample may be different had it been that the whole population was selected. Hence there is a possibility that the sampled SMEs may not give the generality of the SME Industry in Malawi.

### 5.7.2 Limitation by geographical coverage

The current study concentrated on SMEs located in the cities of Malawi only, excluding the rest of the rural areas of Malawi. This was so because of the high concentration of SMEs in the cities, as opposed to rural areas. However, there is no doubt SMEs are also located in rural areas through-out the country. The findings from this study, although they have been used to generalize the income tax compliance level of SMEs in Malawi, may strictly be said not to representative rural SMEs. Rural areas needed to be represented as well. In future research and for more confident and representative results, there is need to consider widening the geographical scope of recruitment, to include rural areas where a few SMEs are located. Despite the above-mentioned limitation, the current study has given valuable understanding of the level of SME income tax compliance and the perceived impact of income tax compliance on SME sales and profitability. For more fully-blown results, it is expected that current findings will incentive prospective investigators to include the rural areas of Malawi. In spite of this limitation, this study found comfort in the standards of interpretive research which observes that generality “is not sought from the setting of a population; rather it supplies an understanding of the deeper structure of a phenomenon that can inform other settings” (Ololube, 2006: p. 112).

### 5.7.3 Survey Strategy limitation

This study was also limited by the use of electronic questionnaire survey approach as a tool for gathering data. The common condemnation regarding the electronic questionnaire survey as a primary data gathering tool is respondents can give subjective and biased responses. Specific for this study, the investigator safeguarded impartiality as much as possible while disseminating the survey questionnaire by making sure that the questionnaire questions and statements were as clear as possible and by explaining terms whenever respondents required clarification. Other surveys coming in future could use a multi approach: questionnaire surveys plus one or two other data gathering approaches such as face to face interviews.

### 5.7.4 Timeframe and Financial Resource constraint

The study is also limited by the short timeframe and inadequate finance resources. The timeframe permitted to carry out the study research is inadequate, in comparison to national surveys which may take many years to be done. As a result, the conclusions and scope of matters discussed in the provided limited time may need to be generalized with caution as replicating the opinions of SME entities in Malawi. It can therefore be stated that the findings regarding this research are to a greater extent limited thoughts of SME entities in Malawi. It would require a lot of economic resources in order to carry out national research. To reduce this constraint to an acceptable low level, the current research's coverage was reduced to a representative sample of 413 SME respondents".

### 5.7.5 Perception versus reality

The study primarily relied on SME owners' and managers' perceptions of tax compliance and its effects on financial performance. While these perceptions offer valuable insights, they may not always align with objective financial data. To enhance the research's rigor, future studies could consider incorporating financial performance metrics, such as profit margins and revenue growth, to cross-validate perceived impacts (Ghauri & Grønhaug, 2010).

### 5.7.6 Cross sectional design

The study employed a cross-sectional research design, collecting data at a single point in time. While cross-sectional data can provide valuable insights, it limits the ability to establish causal relationships or examine changes over time. A longitudinal approach that tracks SMEs over multiple periods could offer a more comprehensive understanding of how tax compliance perceptions evolve and their long-term impact (Bryman & Bell, 2019).

### 5.7.7 External factors

The study did not comprehensively account for external factors that could influence SME financial performance, such as macroeconomic conditions, market dynamics, and industry-specific factors. Future research might consider including a broader range of variables to capture the complex interplay between tax compliance and external influences (Hitt et al., 2019).

These limitations notwithstanding, this study contributes valuable insights into the perceptions of Malawian SMEs regarding income tax compliance and its implications for financial performance. By recognizing and addressing these limitations, future research endeavors can build upon this foundation to provide a deeper understanding of the complex relationship between taxation, SMEs, and economic development in Malawi and similar contexts.

## 5.8 Contribution to knowledge

This section discusses the substantial contribution to knowledge made by the research study focused on Small and Medium-sized Enterprises (SMEs) in Malawi, specifically examining their perceptions of income tax compliance and the resultant effects on their financial performance. The research not only addresses critical gaps in existing literature but also provides valuable insights into the unique context of Malawi

Advancement of research on Malawi SMEs

The study's primary contribution lies in advancing the body of knowledge concerning Malawi's SMEs. Despite their significant role in the national economy, there has been a dearth of research specifically addressing the taxation and financial dynamics faced by Malawian SMEs. By concentrating on this understudied area, the research enhances our understanding of the context-specific challenges and opportunities faced by these businesses.

In-depth understanding of Malawi SME perceptions

The research delves deeply into the perceptions held by Malawian SME owners and managers regarding income tax compliance. This nuanced exploration is invaluable because it reveals the multifaceted factors that underpin their decisions related to taxation. These factors include their judgments of the fairness of tax policies, their apprehensions about the consequences of non-compliance, and their assessments of the benefits associated with tax compliance. This in-depth understanding of SME perceptions helps policymakers craft tax policies that align with SME expectations and enhance voluntary compliance.

Insights into tax compliance behavior

The research contributes to the comprehension of tax compliance behavior among Malawian SMEs. It explores whether the positive or negative perceptions of income tax compliance translate into actual compliance behavior. This knowledge provides guidance for the development of targeted interventions aimed at bolstering tax compliance rates and reducing tax evasion among Malawian SMEs.

Dynamics of financial performance

One of the research's notable contributions is its examination of the intricate relationship between income tax compliance and financial performance among SMEs in Malawi. By scrutinizing whether high levels of income tax compliance positively or negatively impact SMEs' profitability, liquidity, and overall financial health, the research offers insights into the complex interplay between taxation and business outcomes. This understanding empowers Malawian SMEs to make informed decisions regarding tax planning and financial management.

Policy implications

The research findings hold substantial implications for policymakers in Malawi. Armed with insights into SME perceptions and behaviors related to income tax compliance, policymakers can design tax policies and incentives that encourage compliance while minimizing adverse effects on financial performance. Moreover, the research outcomes may inform the creation of tailored support programs to help SMEs effectively navigate tax compliance challenges.

Comparative analysis

While the research's primary focus is on Malawi, its findings are valuable for comparative analysis. By comparing the perceptions and behaviors of Malawian SMEs with those in other countries, researchers and policymakers can identify commonalities and differences. The findings can offer lessons for other developing economies with similar challenges. This research provides a foundation for cross-country comparisons, enabling scholars to assess the transferability of insights to different contexts.

This comparative approach contributes to a broader understanding of tax compliance dynamics among SMEs in diverse contexts.

Developed questionnaire

The developed tax questionnaire has contributed to knowledge by providing original data, context-specific insights, policy recommendations, and a deeper understanding of how SME perceptions of income tax compliance relate to financial performance in the unique context of Malawi. This knowledge can inform policy decisions, support SME development, and advance the field of taxation and SME research in Malawi and beyond.

Developed theoretical framework

The developed conceptual framework offers a comprehensive and multidimensional approach to understanding SME perceptions of income tax compliance in Malawi. By incorporating insights from Institutional Theory, Behavioral Economics, Tax Complexity Theory, and Tax Morale Theory, the framework provides a robust foundation for the research study. It guides data collection, analysis, and interpretation, facilitating a holistic exploration of perceptions of tax compliance dynamics among Malawian SMEs. Ultimately, the framework aims to advance knowledge in the field and contribute to the development of effective tax policies and support mechanisms for SMEs in Malawi

In conclusion, the research investigating SME perceptions of income tax compliance and its effects on financial performance in Malawi makes a substantial contribution to knowledge. It advances our understanding of the unique challenges faced by Malawian SMEs in relation to taxation and provides valuable insights that can guide policy decisions, support mechanisms, and future research endeavors in the field of SME taxation and financial performance, not only in

Malawi but also in similar developing economies. This research is a significant step towards fostering economic growth and sustainability among SMEs in Malawi and beyond.

### 5.9 Recommendations for application

The findings from this study indicate that level of SME income tax compliance is very low. Overall SMEs income tax compliance is found to be at the rate of 40.63%, with 18.9% of SMEs being only partially compliant and 7.7% being absolutely non-compliant. This low level of income tax compliance is found to be attributed to a combination of poor implementation of general tax deterrence elements (tax rates and tax penalties) and behavioral aspects (tax morale) of income tax compliance by the revenue authorities.

It is noted from earlier studies that implementing deterrence procedures (like tax rates, punishment) and tax morale policies in order to achieve voluntary tax compliance is a very complicated endeavor (Prinz, Muehlbacher & Kirchler, 2012). For example, improving tax morale generally implies improving delivery of goods and services to taxpayers, hence causing them to feel treasured, valued and heard. This is regarded as a long strategy, taking very long to make any noticeable impact. According to Halla (2012), policy activities which aim at improving the reciprocal trust among SMEs and the Revenue Authorities are ineffective in the short term as tax morale is generally viewed as very slowly changing" (Hala, 2010 p. 47) while an increase in enforced compliance can be achieved by increasing the standard tools of deterrence, namely audits and penalty (Prinz, Muelbacher & Kirchler, 2012). Tax compliance literature recommends a "careful mix of deterrence measures and morale instruments" in order to achieve high income tax compliance level (Muehlbacher & Kirchler, 2010). What is taken as a correct mix to distinguish between what can be considered as sincere, reasonable power, intimidating and bullying power, can be taken as a matter for another study in the area as it is subject to much argumentation. For the long term, strategies which spur voluntary income tax compliance are considered to work the best, building trust, however, is considered as a long-term process" (Lindbeck & Nyberg 2006, Halla 2010). The current very low level of income tax compliance in the country should be a call for urgent attention.

Below are specific recommendations, all based on results of the study as well as consideration of the literature review section of the study:

i) Tax education and awareness: The Government together with the Malawi Revenue Authority should develop and implement tax education programs tailored to SMEs. These programs should aim to enhance SME owners' and managers' understanding of tax regulations, compliance requirements, and available incentives. Conduct regular workshops, webinars, and outreach campaigns to raise tax awareness.

In a related manner, business associations and Non-Governmental Organizations should collaborate with tax authorities to facilitate tax literacy programs for SMEs. Provide training materials, online resources, and seminars that empower SMEs with the knowledge and skills needed for effective tax compliance.

ii) The tax Authority should come up with some form of tax motivations in form of tax incentives as well as some tax freedoms. The Malawi Revenue Authority should review existing tax incentive programs for SMEs and consider expanding or tailoring them to meet the specific needs of different SME sectors. Evaluate the effectiveness of incentives in promoting compliance and financial growth

Earlier studies have found that one of the good ways to spur income tax compliance is not only to impose punitive deterrence measures for possible tax offenders, but also to engage in exact opposite activities, namely by giving incentives to honest and faithful taxpayers (Mendoza et al. 2015 and Dwenger et al. 2016). This is said to spur voluntary tax compliance and does motivate potential tax evaders to comply voluntarily with the tax regime. This is besides being an inducement to much needed new investors who will in turn result into a broader income tax base. Correspondingly, the Government of Malawi may consider giving direct funding for the improvement of the SME sector by way of some direct monetary provisions and enhancement of investment opportunities focusing on particular areas of interest.

iii) Tax simplification and clarity program: The Malawi Revenue Authority should review and simplify tax regulations to make them more transparent and accessible to SMEs. Reduce the complexity of tax codes and ensure clarity in compliance procedures. Regularly update and communicate changes in tax laws to minimize confusion. Currently, tax laws are considered to be too complex for the majority of tax payers.

iv) Personalized Tax guidance: The Malawi Revenue Authority should offer personalized tax guidance and advisory services to SMEs in Malawi. Assign dedicated tax advisors or account managers to assist SMEs in understanding their tax obligations, planning for compliance, and resolving tax-related issues. Establish tax compliance support centers where SMEs can access tax-related resources, including templates for financial recordkeeping, tax calculators, and compliance checklists. These centers can serve as one-stop shops for tax-related inquiries and assistance

v) The Revenue Authority should increase its income tax support services to SMEs, as an example, SMEs need to be properly and frequently educated and trained in income tax matters which these SMEs are anticipated to comply with as well as the tax planning matters including possible exemptions and incentives they can enjoy. Training and education in automated systems for tax payment will also assist in enhancing income tax compliance. According to Alm and Soled (2016), technological conversion, more especially automated information exchange has the capability of enhancing income tax compliance by nurturing "cashless economies" and high transparency. There is need for the Malawi Revenue Authority to encourage tax payer education in order to improve income tax compliance. According to Gitaru (2017), for SMEs to improve their tax compliances, those involved in their tax matters need knowledge and skills to interpret the various tax laws and regulations.

Tax compliance procedures should be simplified because in most cases they are found to be very complicated by SMEs, especially for those who do not keep proper books of account and sometimes do not understand the tax laws" in order to reduce the compliance costs in terms of money and time".

vi) Consideration should be made to reduce income tax rate which currently stands at 30% of taxable profit made. Taxable profit is arrived at after taking off allowable expenses from the accounting profit. The study found that SMEs in Malawi consider income tax rates to be too high. High tax rates are considered as a key reason for high tax evasion in the country (Chipeta 2002, Chiumia and Simwaka 2012). Increase in income tax rates is met with resistance and more underground activity (Chipeta 2002, Chiumia and Simwaka 2012). Hence reduction in income tax rate should result in more money being left in the hands of SMEs for the furtherance of economic activities of respective SMEs and hence more income tax compliance.

vii) Income taxes should be levied in respect of the size and profitability of the SMEs, after taking into account factors which can retard the growth of similar SMEs. SMEs can only pay income tax to a certain extent and any further cash outflows in form of taxes, according to findings of this study, negates SMEs financial progress. To this effect, a graduated tax system is suggested, where SMEs with higher profits are given a higher rate as opposed to those with a low to no profit. This will in the long run assist to strengthen the financial capabilities of SMEs so that they can easily survive and grow in this unpredictable market.

viii) This study found that males have a more tax compliant attitude in comparison to females. This finding clearly contradicts studies carried out in developed nations. For example, a study by Yimam and Asmare (2020) observed that in emerging nations where females are greatly marginalized and victimized in all material aspects, studies intended to investigate the aim of the behavioral variance in tax mobilization disclosed that business entities held by a women-majority were more income tax compliant than the ones owned by male-majority. Yimam and Asmare (2020) study also showed that where female ownership was 100 percent, there was a higher chance of more than 24 percent of being income tax compliant than where such ownership was 100 percent in the hands of their male counterparts. This anomaly is explained by poorer levels of education amongst women, in comparison to males. It is therefore recommended for deliberate policies to improve women business participation in the country for equity concerns" although, according to this study and due to probable other factors, such women participation did not result in curtailing income tax evasion. As Jackson & Milliron (2016) puts it, usually, women are known with "conforming roles, moral restraints and more conservative life patterns". The study suggests that polices, rules and regulations meant to improve tax administration systems, introduction of new income tax implementation as well as tax audits should all take into account differences in behavior between female and male ownership.

ix) The result of this study as shown under Table 4.48 above, shows that income tax compliance is shown to increase with increasing age of SME owners or managers. The study showed that in general, youthful taxpayers fear less about possible tax audits and any possible penalties (Sistema, Thomas, & Ferrier, 2003). Hence, increasing age of taxpayers had an affirmative impact on the morale of tax (Torgler 2006). There is need for the Government to come up with policies to discourage very youthful participation and instead encourage more mature participants. This could be through loan schemes which are more flexible to older SME owners.

x) There is need for the Government of Malawi to build trust with SME income tax payers. According to Kasper et al (2015), trust building activities are the most effective economic policies for obtaining long term positive effects. Studies have shown a strong and positive impact of training in the area trust in taxation powers that be. Education and knowledge are closely associated with personnel capital (Burgess 2016) and "shadow economy and economic growth are inversely related" (LaPorta and Shleifer 2008). Elements of such trust activities might include a permanent allocation of a percentage of tax collected to some visible developmental activities". As noted above, trust activities are considered as long-term activities, hence these need to be done on a consistent and long-term basis.

xi) The results indicate that income tax compliance result in overall increased performance and profitability of SMEs in Malawi. There is need for the Government to provide a more conducive environment for SMEs to thrive and grow, so that income tax compliance does not become an issue. Most trading entities in the country are considered as micro, small and medium entities. There is need for the Government to craft strategies which will in the short to medium term graduate these SMEs into large entities. The result of this survey shows that the larger the SME, the better the income tax compliance. Income tax compliance has been seen in the results of this study to increase with increasing size of a SME.

xii) The Malawi Revenue Authority should consider carrying out periodic tax audits to SME tax payers. As clarified by Beredugo, Azubike, and Mefor (2017), a tax audit is an independent examination of the income tax returns submitted by the tax payers. According to Beredugo, Azubike, and Mefor (2017):

> A tax audit entails the independent examination or verification of tax returns filed by the tax payer. Tax audit exercise is essentially meant to enable the revenue authority to further satisfy itself that audited financial statement and the related tax computation submitted by tax payers agree with the underlying records. It involves the gathering of information and processing for determining the level of compliance of an organization with tax laws of the territory. According to the OECD (2006), the audit programme of a revenue body is to promote voluntary compliance by taxpayers. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized.

A tax audit is also capable of bringing to bare “significant understatements of tax liabilities”, and may also assist the SME Tax payers to have a proper understanding of the tax applicable tax law as well as assist in identification of areas requiring improvement, which will in turn result into increased income tax compliance going forward.

xiii) The Malawi Revenue Authority should build awareness to the tax payers regarding the importance for SMEs to pay taxes accurately. The study has demonstrated that tax education from the Revenue Authority is considered to be poor. SMEs feel they are not given sufficient tax education, to enable them accurately compute and remit correct taxes.

xiv) Although in the developed world a number of studies found that one of the good ways to spur income tax compliance was not to impose punitive deterrence measures, but to do the exact opposite (Mendoza et al 2015 and Dwenger et al. 2016), there is need for the Revenue Authority to increase punishment deterrence measures like higher penalties and interest rates for non-compliant SME tax payers as this type of deterrence was found by this study to be considered as low and non-deterrent. A certain reasonable amount of deterrence measures needs to be employed in order to make tax evasion unattractive, while at the same time being mindful of not being so excessive as to choke these SMEs with the same taxes.

xv) The study found that tax payers consider that Malawi Revenue Authority does not find it easy to discover tax evaders. Hence the Revenue Authority should up its ability and skills of discovering misbehaving and delinquent tax payers. The Revenue Authority should consider carefully their recruitment strategies. It can be stated that the fear of possible discovery alone will be deterrent enough against tax evasion for several SMEs, let alone actual discovery.

xvi) The study found that SME tax payers are not satisfied with the manner in which the Government spends their taxes. It can be said that there is a feeling amongst tax payers that they are receiving much less in exchange for the tax they pay and that the rest is lost through corruption. Studies submit that Malawians are of the belief that corruption is high among politicians in the country (Chipeta 2002, Chiumia and Simwaka 2012). It can be said that corruption legitimizes evasion of tax. Hence it is recommended for the Malawi Government to step up corruption fight through its relevant anti-corruption agencies. Corruption should not only be fought, but should be seen to be fought by the tax payers.

By implementing these comprehensive recommendations, stakeholders in Malawi can work collectively to improve the tax compliance environment for SMEs. This, in turn, can contribute to the growth and sustainability of SMEs, fostering economic development in the country.

## 5.10 Recommendations for future research

Published income tax compliance studies in the country are very few. Hence this study offers more opportunities for further research.

Further research should continue to explore the nuanced interplay of these theories in various contexts and under different tax regimes to provide more precise guidance for SMEs and policymakers in Malawi. Recent studies elsewhere have begun to examine these interactions, highlighting their relevance in contemporary tax research (Cuccia & Guccio, 2021; Auten & Gee, 2020).

The current study focused on SMEs located in Malawi only, specifically, the four cities of Malawi, namely, Blantyre, Lilongwe, Mzuzu and Zomba. The study is therefore cross sectional in nature, since it was concentrated in the Malawian cities only, as opposed to the rest of the rural areas in Malawi. However, some SMEs are located in rural areas of Malawi too, beyond the cities. The current study can therefore be said to limit the applicability of the findings to other SMEs in the rural areas of Malawi. The study therefore suggests a longitudinal study, a study which will cover the rest of the country in Malawi. Additionally, the current study concentrated on SMEs only as opposed to the rest of the classes of entities in the county. According to Oludele & Emilie (2012), Tee et. al. (2016), SMEs are considered as a vital base for economic development and industrialization in smaller economies" and SMEs are increasingly recognized as units which add considerably to the establishment of employment, economic growth and eradication of poverty in Africa. It must be recognized that the country has large entities too, which approximate to 10% of the entities in Malawi According to the Institute of Chartered Accountants in Malawi.

The study found that SMEs in Malawi consider income tax rates to be too high. High tax rates are reflected as a key reason for high tax evasion on the continent generally and in the country in particular (Chipeta 2002, Chiumia and Simwaka 2012). Increase in income tax rates is met with resistance and more underground activity (Chipeta 2002, Chiumia and Simwaka 2012). Hence it is suggested that a study be done to determine the extent to which the income tax rates need to be reduced in order to be affordable to SMEs. Reduced taxes would result in more money being left in the hands of SMEs and this would spur their overall financial performance and liquidity and subsequently, their growth and related income tax compliance.

Trust activities are said to be "the most effective economic policies for obtaining long term positive effects" According to Kasper et al (2015). Studies have shown a strong and positive impact of training in the area trust in taxation powers that be. Education and knowledge are closely associated with personnel capital (Burgess 2016) and "shadow economy and economic growth are inversely related" (LaPorta and Shleifer 2008). It is therefore suggested that studies be done to identify specific Elements of such trust activity elements to be pursued and in what quantity. Knowledge and quantity of exact trust activities to be pursued will bring confidence to the tax payers regarding their government.

According to Mendoza et al (2015) and Dwenger et al. (2016), one of the respectable methods to motivate compliance with income tax is not to increase income tax deterrence measures like punishment and tax rates, but to engage in exact reverse gear, namely by incentivizing tax compliance through rewards for honest taxpayers. A study is therefore suggested to find out the exact quantum of incentives needed to unlock this compliance.

SME tax payers believe that they are receiving little in exchange for the much tax they remit. Studies done locally have revealed that tax payers believe that corruption is significant amongst politicians in Malawi (Chipeta 2002, Chiumia and Simwaka 2012).
Hence it is recommended that a study be done to identify the amount of exchange between tax payers and the Malawi Government to incentivize tax payers.

**5.10 Conclusion**

This study found that SME income tax compliance was not related to their decision-making process. Income tax compliance was found to have no impact on the decision- making process of SMESs, mostly because the majority of SMEs were not tax-compliant. SME full income tax compliance was found to be at 40.63%, with 18.9% of them being partially compliant and 40.39% of them being fully non-compliant. This low tax compliance from the SME industry in the country, the industry which is regarded as a “key industry and therefore a key source of revenue, must be a matter of worry and concern to the Malawi Government as it has a direct negative impact on the collection of the desperately needed fiscal revenue. To this effect, the study recommends that the Malawi Tax Authority should come up with some tax incentives to woo those who are outside the income tax net as well as to come up with freedoms strategy to reward faithful and honest tax payers. Literature reveals that punitive deterrence measures like tax audits and tax rates alone are not effective at spurring voluntary tax compliance, but a mixture of deterrence instruments and incentives does (Mendoza et al., 2015 and Dwenger et al. 2016). It is recommended to clarify the income tax laws so as to make them easy to understand and comprehend. The study also recommends a reduction in income tax rate to make tax affordable to SMEs as high tax rates are considered as a key reason for high tax evasion in the country (Chipeta 2002, Chiumia and Simwaka 2012). Income taxes should be levied in respect of the size and profitability of the SMEs, after taking into account factors which can retard the growth of similar SMEs. There is need to encourage more women participation in business. Mature participation in business is encouraged as opposed to youthful ones. The Government of Malawi is recommended to build trust and awareness to the tax payers regarding the importance for SMEs to pay taxes accurately. It is also recommended that the Malawi Government steps up corruption fight in order to instill confidence in the tax payers that the money they contribute is all used to develop the country”. A deliberate but carefully coined combination of deterrence power and trust (morale) in authorities is vital in safeguarding medium to long term voluntary tax compliance.

The study found that the main reasons for non-registration for income tax included the following: the business is small, with little working capital hence not ready to pay tax; SME tax payers do not understand what the Revenue Authority does with the income tax money; Income tax rates are considered to be too high; the process of registration is long and the feeling that they haven’t reached the income tax registration thresh-hold yet.

Challenges faced by SMEs when complying with the existing income tax regime were found to be comprised of the following: difficulty in interpreting ambiguous tax guidelines; difficulty in understanding complex tax regulations and laws; lack of resources or expertise in-house; inability to keep up with frequent tax law changes; technology or software-related challenges; inability to calculate accurate deductions and credits; inability to gather and organize necessary financial documents; inability to ensure timely and accurate filing and payment of taxes; difficulty in dealing with audits or tax disputes; inability to navigate complex reporting requirements and managing several types of taxes at the same time. In order to surmount the observed challenges, it was found that SMEs wished the Malawi Revenue Authority (MRA) provided special tax training to SME's; that Malawi Revenue Authority simplified the tax law for the understanding of everyone; that the Malawi Revenue Authority reduced the income tax rate on small businesses; that taxpayers should consider obtaining advice from professionals like Accountants and auditors and that taxpayers should endeavor to keep accurate records.

It was also found that income tax compliance level was related to SME sales and related profitability (Chi-square test, p-value = 0.000). Comparing the three categories of income tax compliance level, the results indicated an increase in SME sales and profit with increasing income tax compliance level - with compliant tax payers showing higher sales than non-compliant tax-payers. Overall, it was found that income tax compliance results into increased sales and profitability of SMEs. This result was not in agreement with the few studies which have been done locally and beyond to explain why tax compliance was generally very low. Studies noted a significant negative relationship between corporate income tax payment and SME financial performance.

Tax deterrence instrument tested (high tax rates to tax offenders) and tax morale instruments (tax incentives, trust in Malawi Government, satisfaction with how the Government spends income tax collected; perceived respect accorded by society and perceived level of tax evasion by other taxpayers in general) were found to be related to income tax compliance level (Chi-square test, p-value < .05).

It was found that tax payers believe that other tax payers find it easy to evade tax; tax payers found it easy to evade tax as level of income tax compliance reduced and vice-versa. The result is not surprising considering the generally low level of full income tax compliance of 40.63% observed in this study. The study also found that MRA does not find it easy to discover tax payers who are not tax compliant. This, again, is not surprising considering the low level of income tax compliance.

The study also disclosed that tax payers consider that tax penalties from MRA are usually high and deterrent enough (punitive enough). This result is however not expected considering the overall low tax compliance rate disclosed by this study (40.63%).

The study also found that a significant minority (of 39.41%) of SME tax payers believed that there weren't good incentives from MRA for firms that are income tax compliant, hence the suggestion that MRA should consider some form of reward to tax compliant SMEs. Lack of incentive scheme coupled with lack of awareness appears to be one of the key factors to the observed low tax compliance.

The study noted that most SME tax payers do not have trust in their government. The level of disagreement was found to increase with increasing tax compliance level.

Tax payers were found not to be satisfied with the way they perceive their government spends the income tax they pay. The level of disagreement was found to decrease with increasing level of tax compliance. Tax-payers also considered themselves to be highly regarded in society. This is surprising considering the overall low-income tax compliance in this study. Many tax payers consider tax evasion to be widespread in Malawi. This belief of widespread tax evasion was found to increase with decreasing level of tax compliance (Tax 65, Pearson Chi2 = 84.22 Prob = 0.0000). This kind of belief among the SMEs should encourage those in authority to put in place mechanisms that can help in finding a solution to this problem.

The study also found that a relationship exists between moderating variables (age, gender, level of education and relative size of SMEs) (Chi-square test, p-value < .05) and income tax compliance. These were considered in light of their perceptions on the impact of SME income tax compliance. Income tax compliance was found to increase with increasing age. In general, "youthful taxpayers fear less about possible tax audits and any possible penalties (Sistema, Thomas, & Ferrier, 2003). Hence, increasing age of taxpayers appears to have an affirmative impact on the morale of tax (Torgler 2006).

Subsequent to analyzing gender variable, it was found that males were more tax compliant than females. The study also had more youthful females in comparison to males. Societal researchers suggest that females comply more, besides, are lesser self-centered than males (Tittle, 1980). Conventionally, women are known with conforming roles, moral restraints and more conservative life patterns" (Jackson & Milliron, 2016). This result was not expected possibly as a result of the youthful element of females in comparison to males in this study. Income tax compliance was found to increase with increasing age, in line with empirical studies.

Income tax compliance was found to increase with increasing level of education.

This is in line with a number of studies done within and beyond the continent. For example, s study by Gitaru (2020) whose aim was to "assess the effect of taxpayer education on tax compliance in Kenya, the case of SMEs in Nairobi CBD" established a clear relationship between education of taxpayers using media such as electronic, print and direct engagement of stake holders.

Respondents of the research were asked to indicate their size in employee number terms. According to the findings, 52.54% of the entities sampled were considered as small while 47.46% were considered as medium. The study found that SME size was related to income tax compliance (Table 75 Pearson Chi2 = 71.71 Prob = 0.0000). The study found a higher compliance rate for bigger SMEs in comparison to smaller ones.

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# APPENDICES

## QUESTIONNAIRE

**Impact of income tax compliance level on financial performance of small and medium sized entities (SMEs) in Malawi**

I am a Doctoral researcher. This structured questionnaire is designed to generate information from you on the Impact of income tax compliance level on the financial performance of small and medium-sized entities (SMEs) in Malawi. Please be assured that data generated are purely for this research, and will be treated with the utmost confidentiality they deserve. Your sincere cooperation is hereby solicited. Thanks.

**<u>Instruction</u>**

Please insert your tick (√) in the box(s) provided to indicate your response: Your identification particulars are not necessary.

## 1 Section A

**Personnel/company characteristics**

1.1 Please indicate your gender:

| | |
|---|---|
| Male | [ ] |
| Female | [ ] |

1.2 Please indicate your age:

| | |
|---|---|
| Below 20 years | [ ] |
| 21 - 30 | [ ] |
| 31 - 40 | [ ] |
| 41 – 50 | [ ] |
| Above 50 | [ ] |

1.3 Please indicate your level of education

| | |
|---|---|
| Primary | [ ] |
| Secondary | [ ] |
| Diploma | [ ] |
| Undergraduate Degree | [ ] |
| Master’s Degree | [ ] |
| Doctorate | [ ] |

1.4 Please indicate the number of years the company/entity has been in existence

1.5 Please indicate the number of years you have worked with the company/entity

1.6 Which of the following best describes your current position

Junior worker [ ]
Senior staff [ ]
Management team member [ ]
Owner [ ]

1.7 Your company/entity falls under the following class of industry

Service [ ]
Manufacturing [ ]
Retail [ ]
Construction & Real Estate Industry [ ]
Other (specify)…………………………

1.8 Total number of employees in your entity/company:

**2. Section B**

***Level of income/corporate tax compliance***

2.1 Our entity/company is aware of the correct income/corporate tax rate (tax charged on profit made)

Yes [ ]

No [ ]

2.2 Please state the correct income/tax percentage rate for your entity [ ]

2.3 Did you company/entity compute its income/corporate tax obligation using the correct tax rate?

Yes [ ]

No [ ]

2.4 When did your company/entity last complete a tax return?

*Never completed one* [ ]

*Completed more than one tax year ago* [ ]

*Completed within the last tax year* [ ]

2.5 Did your company/entity *submit the completed tax return to MRA the last time it did?*

*Never submitted to MRA one* [ ]

*Submitted more than one tax year ago* [ ]

*Submitted within the last tax year* [ ]

2.6 Did your entity/company receive an income/corporate tax *assessment* from MRA within a reasonable time after the return was submitted to MRA?

*Never received an assessment from MRA* [ ]

*Received an assessment late* [ ]

*Received an assessment timely* [ ]

2.7 Was the amount of income tax assessed by MRA on your entity paid by your entity to MRA within the correct period and there are no outstanding income tax liabilities?

*Never paid* [ ]

*Partially paid* [ ]

*Fully paid* [ ]

2.8 How best would you describe the current income tax compliance level of your entity

*Never complied/Never paid income/corporate tax* [ ]

*Partially complied/partially paid income/corporate tax* [ ]

*Always complied/fully paid income/corporate tax* [ ]

**3. General deterrence instruments**

*Key: 1: Strongly disagree; 2: Disagree; 3: Average; 4: Agree 5: Strongly agree*

| | | *Rating (see key above)* | | | | |
|---|---|---|---|---|---|---|
| | | *1* | *2* | *3* | *4* | *5* |
| 3.1 | I consider income tax rates in Malawi to be fair and low. | | | | | |
| 3.2 | I consider income tax law in Malawi to be easy to follow. | | | | | |
| 3.3 | I consider the income tax system in Malawi to be fair to Small and medium entities (like yours). | | | | | |
| 3.4 | I consider that other tax payers generally find it wrong not to pay their income tax obligation to Malawi Revenue Authority (MRA). | | | | | |
| 3.5 | I consider that other tax payers are usually faithful in their income tax payments to MRA. | | | | | |
| 3.6 | I consider that tax payers find it easy to evade (not pay) income tax in Malawi. | | | | | |
| 3.7 | It is easy for MRA to discover tax payers who are not income tax compliant in Malawi. | | | | | |
| 3.8 | I consider that tax penalties from MRA are usually low and non-deterrent (not punitive). | | | | | |
| 3.9 | I consider that it is better for tax payers to comply with income tax voluntarily than to be discovered by MRA first. | | | | | |
| 3.10 | I consider that it is justifiable not to pay correct income taxes if an easy opportunity to do so presents itself. | | | | | |
| 3.11 | MRA provides good tax payer education to SMEs in Malawians. | | | | | |
| 3.12 | There are good incentives from MRA for being income tax compliant. | | | | | |
| 3.13 | I have heard of the 2020 tax amnesty window (voluntary tax window) in Malawi which opened in April 2020 and closes on 31 October 2020. | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 3.14 | The tax amnesty window (voluntary tax window) has assisted our entity to pay any outstanding income taxes without the fear of paying penalties. | | | | | |
| 4 | **Tax morale** | | | | | |
| | *Key: 1: Strongly disagree; 2: Disagree; 3: Average; 4: Agree 5: Strongly agree* | | | | | |
| | | 1 | 2 | 3 | 4 | 5 |
| 4.1 | I have trust in the Government of Malawi | | | | | |
| 4.2 | I am satisfied with the way the Government spends the tax I pay | | | | | |
| 4.3 | I am satisfied with the goods and services being offered by the Government (like security from police; good roads; availability of hospitals; medicines; schools; Agriculture etc.) | | | | | |
| 4.4 | I am highly regarded/respected in my society. | | | | | |
| 4.5 | I consider that income tax evasion (deliberate non-payment of tax) is wide spread in Malawi | | | | | |
| 4.6 | Regardless of whether I am able to pay or not, I am required to pay a tax called “value added tax” on the goods I buy from super markets like Chipiku, Game, Shoprite and other registered shops | | | | | |
| 4.7 | I consider that Malawi’s current income tax system puts a heavier burden on SMEs as compared to large entities | | | | | |
| 5 | ***Impact of income tax compliance on sales and profitability*** *Key: 1: Strongly disagree; 2: Disagree; 3: Average; 4: Agree 5: Strongly agree* | | | | | |
| | | 1 | 2 | 3 | 4 | 5 |
| 5.1 | I consider that our current compliance level of income tax has resulted in overall improved financial performance of our entity | | | | | |
| 5.2 | I consider that profit for our entity is high | | | | | |
| 5.3 | I consider that sales for our entity are high | | | | | |

## Appendix 2: Informed consent form - sample

UNICAF UNIVERSITY

UU_IC - Version 2.0

**Informed Consent Form**

**Part 1: Debriefing of Participants**

**Student's Name:** Ali Nyondo

**Student's E-mail Address:** anyondo@amgglobal.co.mw

**Student ID #:** R1705D2831340

**Supervisor's Name:** Dr Raimi Lukman

**University Campus:** Unicaf University Malawi (UUM)

**Program of Study:** PhD Accounting and Finance

**Research Project Title:** Level and Impact of income tax compliance on enterprises in Malawi – The case of SMEs in Blantyre City, Malawi

**Date:** 13-Jul-2020

**Provide a short description (purpose, aim and significance) of the research project, and explain why and how you have chosen this person to participate in this research** (maximum 150 words).

The main aim of this quantitative study is to assess the level and impact of income tax compliance on the financial performance of SMEs in Malawi – the case of Blantyre during the year ended 31st December 2019. The project uses questionnaires as a primary source of data collection. Your participation involves completion of the questionnaire at either your work premise or from the comfort of your home. Completing the questionnaire should take you about 10 minutes. Kindly note that you were free not to participate. You are also free to withdraw from participating at any stage of my research without any consequences. Your organization was selected because it is one of the Small and Medium Entities within the City of Blantyre, Malawi. My study is concentrating on entities within Blantyre City Central because of my close proximity to the City of Blantyre, Malawi.

The above named Student is committed in ensuring participant's voluntarily participation in the research project and guaranteeing there are no potential risks and/or harms to the participants.

Participants have the right to withdraw at any stage (prior or post the completion) of the research without any consequences and without providing any explanation. In these cases, data collected will be deleted.

All data and information collected will be coded and will not be accessible to anyone outside this research. Data described and included in dissemination activities will only refer to coded information ensuring beyond the bounds of possibility participant identification.

**I,** Ali Nyondo **, ensure that all information stated above is true and that all conditions have been met.**

**Student's Signature:** Ali Nyondo

1

**Informed Consent Form**

**Part 2: Certificate of Consent**

**This section is mandatory and should to be signed by the participant(s)**

**Student's Name:** Ali Nyondo

**Student's E-mail Address:** anyondo@amgglobal.co.mw

**Student ID #:** R1705D2831340

**Supervisor's Name:** Dr Raimi Lukman

**University Campus:** Unicaf University Malawi (UUM)

**Program of Study:** PhD Accounting and Finance

**Research Project Title:** Level and Impact of income tax compliance on enterprises in Malawi – The case of SMEs in Blantyre City, Malawi

I have read the foregoing information about this study, or it has been read to me. I have had the opportunity to ask questions and discuss about it. I have received satisfactory answers to all my questions and I have received enough information about this study. I understand that I am free to withdraw from this study at any time without giving a reason for withdrawing and without negative consequences. I consent to the use of multimedia (e.g. audio recordings, video recordings) for the purposes of my participation to this study. I understand that my data will remain anonymous and confidential, unless stated otherwise. I consent voluntarily to be a participant in this study.

Participant's Print name:

Participant's Signature: ______________________

Date:

**If the Participant is illiterate:**

I have witnessed the accurate reading of the consent form to the potential participant, and the individual has had an opportunity to ask questions. I confirm that the aforementioned individual has given consent freely.

Witness's Print name:

Witness's Signature: ______________________

Date:

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# 1 APPENDIX 3: UREC'S APPROVAL

UNICAF UNIVERSITY

**UREC's Decision**

**Student's Name:** Ali Nyondo

**Student's ID #:** R1705D2831340

**Supervisor's Name:** Dr Raimi Lukman

**Program of Study:** UUM: PhD Doctorate of Philosophy - Accounting and finance

**Offer ID /Group ID:** O19251G18794

**Dissertation Stage:** 3

**Research Project Title:** Level and impact of income tax compliance on enterprises in Malawi – The case of SMEs in Blantyre City, Malawi

**Comments:** Gatekeeper Letter:
the address and the date should be completed

**Decision:** B. Approved with comments for minor revision

**Date:**

# APPENDIX 4: GATEKEEPER LETTER

UNICAF UNIVERSITY

UU_GL - Version 2.0

## Gatekeeper letter

**Address:** ABC SME Entity; C/O Blantyre City.

**Date:** 13 July 2020

**Subject:** REQUEST TO ACCESS YOUR ORGANIZATION

Dear Sir

I am a doctoral student at Unicaf University Malawi.

As part of my degree I am carrying out a study on a study titled Level and Impact of Income tax Compliance on Financial Performance of Small and Medium Enterprises (SMEs) in Malawi - The Case of Blantyre City, covering the financial year ended 31st December 2019.

I am writing to enquire whether you would be willing to participate in this research.

Subject to approval by Unicaf Research Ethics Committee (UREC) this study will be using the questionnaire.

This study will find out if SME's pay fully, partially or not at all, tax charged on business profits, by the Malawi Revenue Authority. The other aim of this study is to evaluate the effect, such observed level of income tax compliance has on financial performance of SME's in the City of Blantyre, Malawi. Financial performance shall be measured by way of perception of levels of profit.
The research questions are to be responded to by way of perceptions, feelings and facts which are turned into numerical numbers, using a three to five point likert scale, for the purpose of analyzing the results quantitatively.
Data will be collected using questionnaires, mostly. Face to face interviews shall be limited to circumstances of merely explaining or obtaining amplification from respondents.

It is unlikely that you will find any question in my questionnaire intrusive. I am however available to

Thank you in advance for your time and for your consideration of this project. Kindly please let me know if you require any further information or need any further clarifications.

Yours Sincerely,

Ali Nyondo

**Student's Name:** N/A
**Student's E-mail:** anyondo@amgglobal.co.mw
**Student's Address and Telephone:** Global House, P O Box 2051, Blantyre. Tel: +265 822 296591
**Supervisor's Title and Name:** Dr Raimi Lukman
**Supervisor's Position:** Supervisor
**Supervisor's E-mail:** r.lukman@unicaf.org