Tax Morale and Tax Compliance among Small Business Enterprises in Uganda

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Abstract
The study was prompted by the high and alarming rates of non tax compliance among Small Business Enterprises in Uganda. The reason of this study was therefore to establish the relationship between Taxpayers’ Morale and Tax Compliance among Small Business Enterprises in Uganda.

A cross-sectional research design together with the explanatory research design and analytical research design were used in the survey. The survey population included Small Business Enterprises operating in Kampala district. Purposive and simple random sampling methods were used to select samples used in the study. Self administered questionnaires were used to collect data from 235 respondents. Data was analysed using SPSS (Statistical Package for Social Scientist).

The study found that Taxpayers’ Morale and Tax Compliance are significantly correlated. Hence, putting in place deliberate strategies aimed at improving the compliance measures would yield high levels of Tax Compliance among Small Business Enterprises. The study recommended that the tax assessment procedures should be improved to enhance trust of the government, Uganda Revenue Authority should establish harmonious working relationship with all stakeholders, and there should be massive sensitization programmes to increase awareness and educate the public as well as remind them that they are partners as opposed to mere subjects who must pay. Once Uganda Revenue Authority adopts this stance, they are likely to be perceived as more accountable and trustable and the taxpaying public will most likely comply in its obligation to pay.

Key words; Tax morale, tax compliance and Small Business Enterprises

Background
Traditionally, tax compliance has been examined in terms of levels of enforcement (Allingham & Sandmo, 1972; Cowell, 1990; Yitzhaki, 1974). Several researchers argue, however, that tax compliance cannot be explained entirely by levels of enforcement (Alm, Sanchez & De Juan 1995; Ellfers, 1991, 2000; Frey 1997; Graetz & Wilde 1985; Torgler 2002). In the face of these difficulties, researchers have suggested other factors that need to be analyzed. It is plausible that tax compliance is affected by other factors such as government services, trust in institutions, perception of others’ tax compliance, social norms and tax morale among others.

In Uganda, a number of Small Business Enterprises (SBEs) are defined as resident business units with a gross annual turnover of not more than fifty million Uganda shillings (Income Tax Act, 1997), remain outside the tax system through tax non-compliance.

Tax compliance means true reporting of the tax base, correct computation of the liability, timely filing of the return and timely payment of the amounts due (Franzoni, 1999). It is easier for SBEs to remain outside the tax net because they can remain inconspicuous to the tax administration. SBEs take loopholes in the tax system in order to minimize their tax payments, hence the non-compliance (Wallace, 2002). In the face of these difficulties, the presumptive income tax system was introduced, to streamline income tax collection and widen the income tax base in Uganda (Sserwanga, 2002).

Presumptive Taxation
Presumptive taxation involves the use of indirect means to ascertain tax liability, which is different from the usual rules based on the taxpayer’s accounts. The term presumptive is used to indicate that
there is legal presumption that the taxpayer’s income is not less than the amount resulting from application of the indirect method (Thuronyi, 1996).

In Uganda presumptive taxation is meant to cater for the incomes of small business taxpayers in the informal sector who do not keep records. Presumptive taxation is basically a method of determining income and tax liability of small business taxpayers with the view of widening the tax base and increasing the tax revenue yield (Tindimwebwa, 1999).

However, high non-compliance rate has persisted irrespective of the tax reforms to include SBEs in Uganda’s tax system (Sserwanga, 2003). In Uganda SBEs seem to reduce their tax payments by non-compliance (Gauthier & Renikka, 2001).

**Small Business Enterprises (SBEs)**

SBEs are defined in respect to the number of people employed, capital employed and sales turnover (Astley, 1997). Belkaovi & Karpic (1998) employed net sales to define SBEs, while (Trotman & Bradley, 1981) used both sales and total assets to define SBEs. UNCTAD, (2000) defines SBEs as a business involving one to five persons, with simple enough activities to be managed directly on a person-to-person basis.

SBEs are defined as those resident business units with a gross annual turnover of not more than fifty million Uganda shillings (UGX 50,000,000). SBEs play a pivotal role in modern industrial economies. In Uganda, according to Hatega (2007) it is estimated that the number of SBEs is more than 1,069,848 which constitutes more than 90% of Uganda’s private sector. The composition being more of the informal sector than the formal sector, mainly dealing in trade, agro-processing and small manufacturing. 80% of these SBEs are located in the urban areas and they contribute 75% of GDP.

In Uganda, a number of SBEs remain outside the tax system through tax non-compliance because they are not un-notified of the tax administration. SBEs find it easier to slip out of the tax collectors’ net, because the enforcement costs would exceed the potential tax revenue collected from the SBEs (Gauthier & Reinikka, 2001). This is associated with the complicated taxation method, which led to the introduction of the presumptive income tax, to streamline income tax collection and widen the income tax base in Uganda (Sserwanga, 2002).

Although the presumptive tax system was introduced as the method of tax, improve compliance, there is still non-compliance among SBEs.

**Tax Morale**

Tax morale is defined as the intrinsic motivation to pay taxes. It is the individuals’ willingness to pay taxes or, in other words the moral obligation to pay taxes or the belief in contributing to the society by paying taxes (Cummings *et al.*, 2004). It is the attitude towards tax evasion or the intrinsic motivation to pay taxes (Torgler B., 2007).

Tax morale is used as a residuum to capture unknown influences on tax evasion (Frey & Feld, 2002). Than being extrinsically motivated by material incentives, intrinsic motivations largely determine tax compliance (Carroll, 1987). Torgler (2001) suggested key factors that seemed to be important for understanding tax morale. They include;

**Trust in Government**

It is the relationship taxpayers have with their government. Torgler (in press) confirmed that these concepts predicted levels of tax morale in Latin America. Two core variables were used to explore the relationship taxpayers had with authority. The variables are TRUST IN THE LEGAL SYSTEM and
TRUST IN THE PARLIAMENT. These two variables allow us to analyze trust at the constitutional level (e.g., trust in the legal system), focusing on how the relationship between the state and its citizens is established, and also allow us to analyze trust more closely at the current politico-economic level (e.g., trust in the parliament).

Religiosity
According to Torgler (2001), he argued that moral sentiments were important for understanding tax morale. There are many behavioral norms and moral constraints that are strongly influenced by religious motivations. Previous empirical studies published in the criminology literature show for example, that states and countries with higher rates of religious membership have significantly lower violent and non-violent crime (see Hull, 2000; Hull & Bold, 1989; Lipford, McCormick & Tollison, 1993).

Economic Situation
Earlier research has shown that a person’s ECONOMIC SITUATION can affect their level of tax morale. Proxies of a person’s economic situation are TAX RATE, INCOME and SOCIAL CLASS was therefore used as predictors of tax morale in the present analysis. The effects of tax rate and income level on tax evasion are difficult to assess theoretically, and often the findings have been mixed (see Jackson & Milliron, 1986). The study depends on an individual’s risk preference and the progression of the income tax schedule (Andreoni, Erard & Feinstein, 1998). A higher marginal tax rate makes tax evasion somehow more profitable, but a contrary effect works depending on the risk aversion of taxpayers.

Pride
Pride produces a sense of group identification. Such group identification can for example found in international soccer games like the FIFA World Cup. Tyler (2000) argues that pride influences people’s behavior in groups, organizations and societies. It gives a basis for encouraging cooperative behaviour. Interestingly, to the author’s knowledge the effects of pride on tax cheating have not been documented in the economic literature. It can be hypothesized that people who are proud to be citizens of their country are more loyal, better identified with the state and have thus higher tax morale. Hypothesis 2: The greater the citizens’ national pride, the higher the tax morale.

Democracy
It might be interesting to analyse whether a pro democratic attitude has a positive effect on tax morale. In general, democracy offers citizens the possibility to express their preferences. A more active role helps citizens to better monitor and control politicians and thus to reduce the asymmetry of information between them and their agents (government), which reduces the discretionary power of the latter.

Tax Compliance
Tax compliance typically means, true reporting of the tax base, correct computation of the liability (accuracy), timely filing of the return, and timely payment of the amounts due (timeliness) (Franzoni, 1999). Tax compliance in respect to income tax is defined as the ratio of declared income to actual income (Chang-Gyun, Hyun & Yoo, 2000). Tax non-compliance happens when taxpayers intentionally fail to comply with their tax obligations, resulting to loss of revenue, which may cause serious damage to the proper functioning of the public sector (Franzoni, 1999).

Tax Morale and Tax Compliance
Tax morale may help to explain why people willingly conform. If tax morale is a key determinant in enhancing tax compliance there are a variety of policies besides coercion that will help to reduce tax fraud. To derive policy recommendation from these results it is necessary to go a step further and explore the determinants of tax morale. Studies have explored the factors that shape tax
morale in an attempt to gain a broader understanding of this issue (see, e.g., Torgler, 2007a). It is important to address this deficiency because the state and the tax administration have a variety of methods available to influence tax compliance; traditional approaches such as deterrence can be seen as just one possible instrument. Historical examples also indicate that states—can be strong with regards to specific capacities, for instance coercion and repression, without—producing voluntary compliance, a phenomenon to be observed in many transition countries... This also means that they are weak with regard to their political capacity to rely on voluntary compliance (Hayoz and Hug, 2007, p. 9).

It is valid to question whether there is any link between tax morale and tax evasion, and previous work in other areas suggests a possible connection between attitudes and behaviour (Torgler 2007). Spicer and Lundstedt (1976) pointed out that the choice between tax compliance and evasion is not only made on the grounds of sanctions but also set of attitudes and norms. Allingham and Sandmo's (1972) groundbreaking model assumed that the extent of tax evasion is negatively correlated with both the probability of detection and the degree of punishment. This model has been widely criticised on many fronts (e.g., Graetz and Wilde, 1985; Alm, McClelland, and Schulze, 1992). In many countries, the level of deterrence is too low to explain the high degree of tax compliance, and in seeking to resolve this puzzle of voluntary observance, researchers argued that tax morale can help explain the high degree of tax compliance (see Torgler, 2007). Lewis (1982) points out that 'it could be that tax evasion is the only channel through which taxpayers can express their antipathy … we can be confident in our general prediction that if tax attitudes become worse, tax evasion will increase’

**Methodology**

A cross-sectional research design was used together with the explanatory research design and analytical research design, to ascertain the relationship between tax morale and tax compliance among SBEs in Uganda.

The population consisted of SBEs operating in Kampala district estimated to be 37,500 as in the Uganda Bureau of Statistics 2002. Using systematic and purposive sampling a sample size of 380 was selected basing on Krejcie & Morgan (1970) table. Where they contend that a sample size of 379 is appropriate for a population of 30,000 and 380 is appropriate for a population of 40,000 SBEs. Therefore given a population of 37,500 SBEs in Kampala district, a sample size of 380 was used for this study.

Systematic sampling was used to select the 380 SBEs. The first company was selected randomly from the list availed by Uganda Small Scale Industries Association (USSIA) and thereafter every other 99th SBE was selected. Purposive sampling was used to select respondents in the firms. These were managers and business owners because they had the relevant information relating to tax compliance that was needed to realize the objectives of the study.

The study used both primary and secondary. Primary data was obtained from respondents using self administered questionnaires as well as interview administered questionnaires. Secondary data was collected from previous studies on SBEs, documents and journals obtained from Uganda Manufacturers Association, Uganda Revenue Authority, World Bank Library, Institute of Public Certified Accountants of Uganda, Ministry of Trade and Industry, records of SBEs umbrella organizations and other professional journals and published literature and Internet libraries. The self administered questionnaire consisted of mainly closed-ended questions using a 5 point–scales ranging from 1-strongly disagree to 5-strongly agree. The questionnaires were prepared in English but translated into Luganda (local language) for non-English speaking respondents.

For quality control, a pre-test of the research instruments to establish their validity was done. The instrument was given to two experts to give their opinions on the relevance of the questions using a 5-
point scale of relevant, quite relevant, not sure, somewhat relevant and not relevant. Content Validity Index (CVI) of 0.974 and 0.872 were attained this is way above 0.5 the acceptable minimum.

The reliability of the questionnaires was tested using the cronbach’s alpha coefficient. The acceptable minimum is 0.5. The reliability of the questions used in the study range from 0.6206 to 0.8110 which is above the acceptable minimum of 0.5, as seen in the table below.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Alpha Cronbach’s coefficient</th>
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<tbody>
<tr>
<td>Taxpayers’ Morale</td>
<td>0.6206</td>
</tr>
<tr>
<td>Tax Compliance</td>
<td>0.8110</td>
</tr>
</tbody>
</table>

This indicates that the instrument used to collect data from the respondents was dependable and reliable and yielded good results. The results and conclusions of this study can be significant for decision making.

The data collected was edited, coded, and analysed to identify the relationship between the variables. Data was analyzed using SPSS. Descriptive statistics were used to describe the data. Correlation and multiple regressions were used to show strength and nature of the relationships, predictability and variability in tax compliance.

Measurement scales were adopted from previous studies carried out in more developed countries. The scales were adapted to suit the Ugandan setting to make them relevant.

Some respondents feared to respond to the questionnaire because they felt that the information that was required was private. To alleviate this fear the researchers obtained an introduction letter from Makerere University Business School (MUBS) to assure the respondents that the information they would used for academic purposes and confidentiality would be ensured.

**Findings**

The demographic features of respondents include the category of the respondents, gender, age, and level of education, longevity of the business and the nature of business. The largest proportion was owners of enterprises compared to managers. The owners of enterprises were 72% compared to 28% for managers. This means that most of the small business enterprises in Uganda are managed by their owners. Majority are male with 80% compared to 20% who are female who were 30 years and above. This category represented 77% compared to 23% who were 30 years old. Those above 30 years fell in the age bracket of 30 to 39 years with 45% of the respondents.

**Level of Education of the Respondent**

![Education level](source: derived from survey data)
Findings revealed that 69% had degree and 24% are certificate and diploma holders, 7% reached secondary school level and none at primary level. The finding is that, most Small Business Managers and owners are highly educated to understand the need for taxation.

**Number of Years in Business**

Majority have been in business for less than 5 years represented by 31% to 27% who were in business for 6-10 years, 26% were in business for 11-15 years and 16% were in business for more than 15 years.

**Figure 2: number of years in business**

The above clearly explains the current high births and high deaths of SBEs in Uganda.

**Relationship between Taxpayers’ Morale and Tax Compliance**

Inferential analysis was done where by correlations were obtained to establish the relationship that exists between variables conceptualized in the framework.

**Table 2: Spearman’s’ Correlation Matrix**

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<th>2</th>
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<tbody>
<tr>
<td>Tax Payers Morale (1)</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>Tax Compliance (2)</td>
<td>0.400**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

*Source: Primary data*

** Correlation is significant at the .01 level (2-tailed).

From the correlation matrix it can be noted that there was a significant positive relationship between taxpayers’ morale and tax compliance (r=0.400, P-value <0.01). It indicates that, taxpayers’ morale positively influence tax compliance. It shows that, when taxpayers’ morale improves, then tax compliance would proportionately improve. Hence in the attempt to improve tax compliance, URA has to try and put in place techniques to improve taxpayers’ morale.

**Conclusion**

Taxpayers’ morale and tax compliance were found to be significantly correlated. The aspect of taxpayers’ morale gains importance because the act of paying taxes cannot be fully explained by a standard economic expected utility approach. People pay their taxes, although there is a low probability of getting caught and being penalized. Thus, the degree of taxpayers’ morale has consequences for real behavior, and it can be concluded that it is responsible for the behavior of tax.
compliance as indicated in the findings of this study. Therefore the results obtained indicate that the more taxpayers’ morale the more the tax compliance.

A significant body of research on tax compliance has been accumulated. Much work has concentrated on traditional topics, such as the impact of audit, penalty, and tax rates on compliance. However, there is overwhelming evidence that observed tax compliance behavior cannot be explained entirely with the traditional economic analysis that focuses mainly on deterrence components. Instead, there are several other factors that help explain why many people are compliant, especially the notion of tax morale. It can be concluded that taxpayers’ morale affect tax compliance. The changes in taxpayers’ morale would cause a linear change in the tax compliance of small business enterprise owners and managers.

Bibliography

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