Impact of the income tax system on tax payers' satisfaction: With special reference to Kegalle district income tax payers

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Abstract

Tax system of a country is the primary mechanism of revenue generation. In Sri Lanka tax revenue has a declining trend over the past 15 years. According to literature, the income tax system of Sri Lanka has failed to generate sufficient revenue due to its inherent weaknesses. Further, there is relatively a few number of articles and journals published about the income tax system and it has not yet been covered the perception of the tax payers towards the income tax system. Hence, intention of this paper is to fill the gap in the literature by examining the impact of income tax system on tax payer satisfaction, ascertaining the relationship between income tax system and tax payer satisfaction and identifying the most affecting factor to tax payers' satisfaction. In this study, tax system is conceptualized as multidimensional construct which depends on four dimensions such as Fairness, Tax Compliance, Tax Competencies and Simplicity. Primary data were gathered through distributing a self-administrative questionnaire and 120 individual income tax payers were selected proportionately from each income category by using Judgmental sampling. Descriptive statistics, Correlation coefficient analysis and Regression analysis were used for the purpose of data analysis. The research findings revealed that there is a strong positive correlation between tax competencies and tax payer satisfaction while other three dimensions have a weak positive correlation. Further, tax competencies and simplicity were identifies as highly affected factors to the tax payers' satisfaction. Hence, it can be concluded that tax competencies is the most important income tax system dimension and the satisfaction of taxpayers is based on their knowledge and understanding of tax law and awareness of paying tax. In addition, the low complexity of income tax system reduces the tax evasion. The study suggests that government needs to build a positive morality of the tax payers through conducting awareness programs, providing transparency with regarding the tax revenue and introducing several facilities.

Keywords: *Tax compliance, Tax evasion, Tax competencies, Fairness, Simplicity*

1. Introduction

Sri Lanka is seeking a rapid economic growth after ending the thirty years old civil war targeting at doubling per capita income. To ensure the rapid economic growth, it is vital to make sure the equitable income distribution. Taxation can be used as a tool to ensure the income distribution of the economy. Tax system of a country affects the economy of that country in many ways and it is the primary mechanism of revenue generation. Since fiscal deficit is notably high in Sri Lanka, taxation is crucial in generating government revenue. Income tax is one of the important sources of revenue to government in both developed and developing countries. Similarly, it is the one and only direct tax revenue to the government. But in Sri Lanka there are few numbers of people who comply with the income taxes at a level of 36% and according to the performance report of Inland Revenue Department, income tax revenue in Sri Lanka has seen a gradual decline over the past years. As cited in Slemrod and Bakija (1996) Albert Einstein once said that the hardest thing in the world to understand is income tax. People think "tax" is an excess burden on them, which reduces their savings. Such perceptions tempt them to avoid tax payments without considering the long term effects it may have on the nation. Athukorala and Jayasuriya (1994) and Waidyasekera (2004) note that the tax system of Sri Lanka has failed to generate sufficient revenue as a result of its inherent weaknesses. Therefore, an effective and efficient tax collection system is vital in order to ensure revenue maximization. For instance, giving taxpayers the opportunity to make proposals on the usage of tax revenues increases satisfaction with paying taxes.(Whillans, Wispinski, & Dunn, 2016)

When comparing to other Asia Pacific Regions there is relatively a few number of articles and journals published in Sri Lanka about the income tax system and it has not yet been covered the perception of the tax payers towards the income tax system. Thus, there are very few sources for people to get educated and create a positive attitude towards income tax system in Sri Lanka. Therefore, this study attempts to fill the gap in literature by identifying the tax payers' satisfaction about the income tax system that is currently implemented in Sri Lanka.

2. Literature review

The literature supporting the research question raised in this study is summarized below. Accordingly, theoretical clarifications on dimensions of the Income Tax System will be presented initially. Secondly conceptualizations on tax payers' satisfaction will be discussed.

2.1 Fairness

Jackson and Milliron (1986) described tax fairness as one of the most important variables that influences tax compliance behavior. When any tax system is unfair, that system as a whole will be considered by tax payers as a bad tax system and tax payers' compliance to that system will be unreasonable. To be a fair tax, tax payers should have the ability to pay and the tax itself should be characterized by its horizontal and vertical equitable (Jones, 2007). Moreover, Song and Yarbrough (1978) found that there is a significant relationship available between tax fairness and tax evasion.Hite and Roberts (1992) examined the relationship between tax fairness and tax payers' evasion. This study found that tax fairness was significantly associated with perceptions of an improved tax system and that

tax fairness and tax evasion were related. Identifying tax fairness dimensions is useful to the tax authorities to improve the fairness of the tax system and it leads to better tax compliance (Azmi & Perumal, 2008).

2.2 Tax Compliance

Tax compliance can be defined as the degree to which a tax payer complies or fails to comply with the tax rules of their country. The theory of tax compliance was pioneered by Allingham and Sandmo (1972)within the framework of game theory. Further, it has been identified a statistically significant relation between tax-compliance attitude and factors such as the perception of probability of audit, corruption, satisfaction with the tax administration, peer influence, gender and education (Yesegat & Fjeldstad, 2016). According to Plumley (1996) voluntary tax compliance is explained by dimensions like timely filing of any required return, accurate reporting of income and tax liability and timely payment of all tax obligations. Kirchler (2009)defines tax evasion as illegal and involving deliberate breaking of tax law in order to reduce the amount of tax due. Compliance costs are costs incurred by taxpayers, in addition to their tax liability, in conforming to the tax requirements. Results of many of these studies suggest that tax complexity increases compliance costs.

2.3 Tax Competencies

Literature emphasizes tax awareness as an explanation as to why some tax payers engage in legal tax avoidance activities while others do not. In the Self-Assessment System (SAS), tax awareness among tax payers plays an important role on tax compliance. Therefore, the level of

tax education and tax knowledge is significant to ensure the tax administration to be going well. As a result, tax payers will be able to assess their tax liability correctly and to file tax return forms on time. The influence of knowledge on compliance behavior has been proven in various researches (Khan, 2007). Harris (1993)divideknowledge into two aspects, namely, knowledge through common or formal education received as a matter of course and knowledge specifically directed at possible opportunities to evade tax. In the first case, the level of education received by the tax payers is an important factor that contributes to the general understanding about taxation especially regarding the laws and regulations of taxation. Eriksen and Fallan (1996)reveled that with reasonable understanding of the tax laws, people are willing to respect the tax system.

2.4 Simplicity

Tax simplicity appears to be a desirable feature of a tax system. A simpler tax system reflects a reduction in complexity and is identified as one of the variables that affects tax compliance (Jackson & Milliron, 1986). An early study has shown that complicated tax returns, feelings of uncertainty and demands for legal completeness are some of the tax complexities experienced by many tax payers that subsequently deter them from complying (Vogel, 1974). It is argued that a simple tax system consists predictable, clearly communicated and consistent rules that are well integrated with other tax rules that may consequently increase the compliance (McKerchar, 2002). The complexity of tax laws makes it difficult for tax payers to understand. Although taxes are not a part of everyday conversation, people will normally try and make sense of the contribution that they make to the government through the payment of taxes. When

trying to sense, they will evaluate the fiscal policy, the tax rates, the provision of public goods and services and the interaction between themselves as taxpayers and the tax authorities. Thus, complexity can be identified as most important determinant of tax evasion across countries, and that tax compliance is low in countries with a complex tax system.

2.5 Tax Payer Satisfaction

A tax payer is any person or organization required by law to pay tax to a governmental authority. In collecting the tax, the tax payer should have a good willingness. Willingness of tax payers to pay their tax obligation is important in the tax collection. The lack of willingness is caused by the principle of taxation, namely that the results of the tax collection indirectly enjoyed by the tax payers. The willingness to pay tax can be interpreted as a value to be contributed by a person willingly that are used to finance state expenditures that does not receive reciprocally retain (Kusbandiyah & Fakhruddin). This willingness may be influenced by several factors, such as paying taxes awareness, knowledge and understanding of tax laws, and a good perception of the effectiveness of the tax system. The willingness of tax payers to pay taxes is an important factor for increasing tax revenue. Studies suggested that the tax law complexity may decrease the compliance by creating opportunities for noncompliance (Graetz & Wilde, 1985; Milliron, 1985). A tax payer may perceive that the tax law complexity makes interpretation of tax laws difficult.

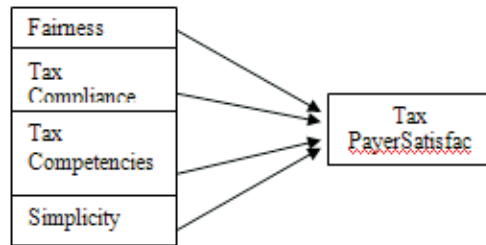Accordingly, the conceptual framework (figure 1.1) can be established as follows.

Figure 1.1: Conceptual framework

3. Research methodology
3.1. Population and sample of the study

The population of this study was comprised with the all individual income tax payers registered in Kegalle district regional tax collecting office as at end of the year 2014. There are 20 income categories which tax payers registered under income tax. Thus, The sample size of 120 individual income tax payers were selected proportionately from each income category by using judgmental sampling who have the ability and knowledge to provide required information.

3.2 Data Collection

Required information was collected from both primary and secondary data. Primary data were collected by using a structured questionnaire and secondary data were collected through other relevant reports.

3.3 Data Analysis

The descriptive statistics; percentages and graphs and tabulation techniques were used to describe the profile information of the sample. Correlation coefficient analysis was used to ascertain the association between income tax system and tax payer satisfaction. Further, impact of income tax system on tax payer satisfaction was tested by using regression analysis.

4. Results and discussion

The following section provides a brief account of the studied sample and that will be followed by the interpretation and discussion of the outputs of correlation coefficient analysis and regression analysis employed so as to achieve the objectives of the study.

4.1 Profile of the sample

According to Figure 4.1, majority of the sample (73.33%) is comprised with male income tax payers. Age distribution of the sample includes 5 age categories and the highest number of income tax payers is represented by 40 49 years age group as a percentage it is 39 % (Figure 4.2). Furthermore, Most of the tax payers had completed education up to Advance Level (42 %). The outcome of the research further showed that 30 % of tax payers have diplomas and 17 % of tax payers belong to the category of graduates (Figure 4.3).
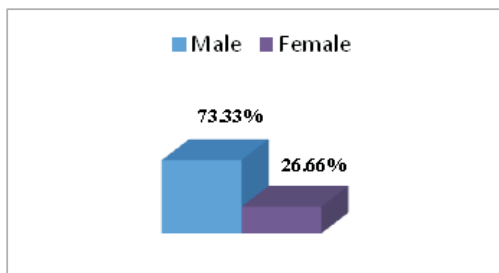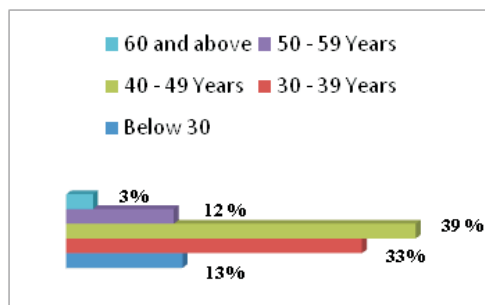

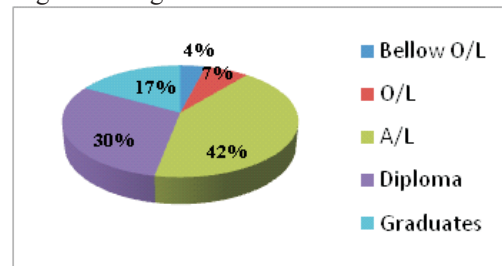Figure 4.1: Distribution of Gender

Figure 4.2: Age Distribution

Figure 4.3: Education qualification

4.1. Association between income tax system dimensions and taxpayer satisfaction

The summary outputs of correlation coefficient analysis are presented in the table 4.1. Accordingly, there is a strong positive correlation between tax competencies and taxpayer satisfaction while other three dimensions namely fairness, tax compliance and simplicity have weak positive correlation.

Table 4.1 Summary of correlation analysis

Dimensions	Pearson Correlation	P – Value	Sig: Level
Fairness	.434	.000	0.05
Tax Compliance	.235	.010	0.05
Tax Competencies	.636	.000	0.05
Simplicity	.370	.000	0.05

4.1. Impact of income tax system on taxpayer satisfaction

According to the outputs of table 4.2, R square implied that approximately 64% of variation in dependent variable is explained by independent variables. It is further

supported by the values of multiple linear regressions as to the table 4.3 tax competencies and simplicity was highly impact to the tax payers' satisfaction. However the tax system dimensions of fairness and tax compliance were not significantly contributed to the model as its p values were greater than 0.05 level of significance.

Table 4.2 Model summary of multiple linear regression analysis

Model	R Square	Adjusted R Square	Std. Error of the Estimate
1	.636	.612	.548

Table 4.3 Multiple linear regression analysis

Predictor	ß	Std: Error	t-Value	P-Value
Constant	.98	.36	2.70	.008
Fairness	.16	.09	1.71	.089
Tax Compliance	-.14	.08	-1.62	.106
Tax Competencies	.55	.08	6.67	.000
Simplicity	.25	.11	2.32	.022

5. Conclusions and suggestions

This study was conducted with the aim of ascertaining the relationship between income tax system dimensions and tax payer satisfaction, identifying the most important income tax system dimension to build tax payers satisfaction and examining the impact of income tax system on tax payer satisfaction. The findings revealed that all income tax dimensions have a relationship with tax payer satisfaction at 95% confidence level. However, tax competencies have a strong positive correlation with the tax payer satisfaction while other three dimensions have a weak positive correlation. Hence, tax competencies can be identified as the most important income tax system dimension which helps to build tax payer satisfaction. It can be concluded that satisfaction of taxpayers is mainly based on their knowledge and understanding of tax law and awareness of paying tax. In addition, the low complexity of income tax system reduces the tax evasion and increase the tax payer satisfaction.

All in all, what makes clear is that there is a higher need of reducing the frustration and disappointment of taxpayers regarding the current income tax system in Sri Lanka by conducting awareness programs and enhancing government expenditures from tax revenue. Besides, most of the people are not aware of income tax rates & the content of the income tax act. Thus, the income tax act should be prepared in a simple & understandable manner. Introducingof a fully automated tax system such as e filling system and e payment system can reduce the paper works and save the time. Providing facilities such as privileged card system, credit facilities, leasing facilities to the taxpayers who pay more taxes can build the positive morality of tax payers.

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