The Influence of Tax Complexity on Sales Tax Compliance among Jordanian SMEs

Ahmad Farhan Alshira'h[1], Hasan Mahmoud AL-Shatnawi[2], Mohammad Khalil Alsqour[3], Malek Hamed Alshirah[4]

[1,2,3]*Faculty of Administrative Sciences and Financial, Department of Accounting, Irbid National University, Jordan*
[1]*E-mail: alshraah.ahmad@yahoo.com (Corresponding author)*
[4]*Faculty of Finance and Business Administration, Department of Accounting, Al al-Bayt University, Jordan*

Abstract

Tax compliance has been evidenced to mitigate fiscal deficit and public debt, which in turn, provides funding for the purpose of economic and social development. However, regardless of the efforts exerted by the government towards tax compliance, specifically sales tax among SMEs in Jordan, compliance remains low, which adversely impacts the revenues of the Jordanian government. Prior studies dedicated to the effect of tax complexity on sales tax compliance among SMEs have been limited and thus, this study's main objective is to examine the influence of tax complexity on sales tax compliance among manufacturing SMEs in Jordan. The study adopted a survey method, using questionnaire survey copies administered on 660 owner/managers of manufacturing SMEs. From the disseminated questionnaire copies, 215 were retrieved and deemed suitable for analysis. Based on the obtained results, tax complexity significantly influenced sales tax compliance. This study recommends that future studies be conducted in sales tax compliance, in the context of SMEs for deeper insight into its drivers. The study contributes by furnishing significant information that policymakers and SMEs owners/managers can leverage to enhance the level of sales tax compliance.

1. Introduction

When it comes to government facilitation of public services, it is pertinent that it has sufficient funds to develop and maintain infrastructure, social services and to make sure that there are sufficient services provision. In this background, taxation has been a significant resource for the state and society (Alshira'h *et al.*, 2018), where its tax revenue collection play a significant part in the issue of taxes. Following the recent economic crisis (2008), increasing public fiscal deficit of states has called for the need to gather more tax revenues, particularly in the face of the state's refusal to participate in universal collaboration to resolve the issue of tax non-compliance (Sawyer, 2014). Moreover, increasing levels of tax non-compliance behavior among taxpayers should be a main priority of tax authorities and governments all over the globe (Puspitasari & Meiranto, 2014). Tax revenues can be enhanced through the encouragement of tax compliance behavior, and thus, tax compliance should be kept into consideration by all countries (Franzoni, 1999). Significant issues are brought up for governments and tax authorities when it comes to the causes of tax non-compliance as this influences the economic justice and effectiveness (Devos, 2005). It is a critical

and compounding issue in all economies and societies in countries all over the globe (Alshir'ah *et al.*, 2016; Randlane, 2016).

More importantly, sales tax compliance is also an independent issue as throughout the past decades, it has taken the place of sales tax in different countries, while maintaining its attractiveness to new converts (Das-Gupta & Gang, 2003). More specifically, sales tax, or value added tax (VAT) as majority of countries refers to it (e.g., Britain, the US, France and Malaysia), was first introduced as a type of tax in France in 1954, as consumption tax on goods imposed on the level of production (Adams & Webley, 2001). Faridy *et al.* (2016) described sales tax as pertinent in the provision of tax revenue base among governments, and this holds especially true in developing nations. Non-compliance to it remains at a high level and thus, effective sales tax enforcement is required to prevent such non-compliance (Lee, 2016). Activities driving compliance are deemed to be a burden in SMEs in comparison to other types of tax (Hansford & Hasseldine, 2012).

It is notable that the sales tax evasion and fraud is an issue that is widespread and not limited to EU countries or to developed nations, in fact, it is more prevalent in the developing ones (Keen & Smith, 2007). Having mentioned that, it is unfortunate that empirical studies dedicated to sales tax compliance are still lacking (Alshira'ah *et al.*, 2018), despite the fact that developing nations largely depend on tax revenue from indirect taxes as opposed to direct taxes (Huang & Rios, 2016). In the Jordanian case, there has been an increase in the shadow economy from 19.4% (1999) to 20.4% (2000) of the GDP, which led to the promotion of sales tax from 10-13% in 1999 as related by Alkhdour (2011). More increase was noted in the shadow economy from 22.1% (2010) to 24.5% (2015) of the GDP (Jordanian Economic Social Council, JESC, 2014).

In the same line of study, Arachi & Santoro (2007) indicated that SMEs are primary contributors to the shadow economy in the developing nations and Pope and Abdul-Jabbar (20080 stated that SMEs taxation has been in the limelight in the past decade in both nation groups (developed and developing). Added to this, SMEs tax compliance needs focus in that the issue is widespread among SMEs who have been reported to fall short of meeting their tax compliance (Swistak, 2015). According to the Young Entrepreneur Association (YEA, 2011), approximately 87% of small enterprises and 35% of medium ones do not comply with tax payment in Jordan, and this is compounded by the fact that SMEs in Jordan constitute 99% of the total enterprises. In this line of query, the factors driving tax compliance behavior among SMEs have yet to be confirmed and thus, the main objective of this study is to examine the factors that lead to high level of tax non-compliance among SMEs in Jordan.

According to Al-Naimat (2013), in Jordan, taxes are primary government sources of revenue, with taxes playing a key role in the development of the country as evidenced by the sharp economic country in 1988, and following the country's adoption of the International Monetary Fund (IMF) economic adjustment initiative in 1989. The government of Jordan has been exerting efforts to introduce reforms to the tax system, for efficient system, increased tax revenue and mitigated dependence on non-tax revenue. Owing to the limited economic resources of Jordan, chronic budget deficit has been experienced and thus tax is deemed to be a crucial resource to use in financial social and economic projects in the country (Alshirah *et al.*, 2018).

2. Literature review and hypotheses development

2.1. Tax Compliance

In both state categories (developed and developing), taxes are considered to be a prerequisite of total domestic revenue, where countries promote their economy through direct and indirect taxes (Torgler & Schaltegger, 2005; Palil, 2005). All people are mandated to pay taxes (corporate or individual) and are expected to voluntary adhere with the laws and regulations of the tax regulating body. Nevertheless, some people escape from their tax duties as noted by Kirchler *et al.* (2014) and those who do so pose a critical challenge to the tax agencies (Alm, 2019). Tax compliance generation and guarantee largely hinges on the taxpayers' participation in the decisions and expenditures of government (Alm *et al.*, 1993), along with increasing penalties and tax audit (Alm & Torgler, 2011). Considerable efforts have been directed towards tax compliance enhancement, but it remains a complex and ongoing issue in the current times. In fact, tax compliance is one of the contemporary issues, especially in the developing nations, who are attempting to

identify methods to enhance the efficiency of tax revenue collection to support financial budgets (Maseko, 2014).

As yet, there is no standard for tax compliance definition in literature but tax compliance is generally referred to as the ability and inclination of the taxpayer to adhere to tax laws, determined by ethics, legal environment and other situational factors at a specific place and time (Palil & Mustapha, 2011; Kirchler *et al.*, 2006). Interestingly, tax compliance has also been viewed as a game, which is dependent on reciprocal interactions between the taxpayer's decisions and tax agaency, and the trust of the former on tax law and tax system fairness (Kirchler *et al.*, 2006). There are multiple measures to tax compliance mentioned by Brown and Mazur (2003) that is mandated to taxpayers namely adhere to reporting compliance, filing compliance and payment compliance.

More importantly, tax compliance has been synonymously used with the terms tax avoidance, tax evasion and tax fraud throughout literature dedicated to the topic, with several authors distinguishing between tax evasion and tax avoidance. Specifically, tax non-compliance refers to a form of tax evasion or tax avoidance that depends on the grade of legality of the taxpayer's business (illegal or legal) (Likhovski, 2007). Meanwhile, tax evasion entails illegal and intended business that institutions and individuals take up to minimize their due legal tax commitments through under-reporting of sales, income or wealth, exaggeration of deductions, dispensations, or loans, or falling short of filing suitable tax returns (Ritsatos, 2014). According to Kasipillai *et al.* (2003), tax evasion is a premeditated action of tax non-compliance to produce tax lower than what is due, while Abdul-Jabbar & Pope (2008) revealed that tax evasion constitutes elements of illegal activities along with the inclination of the taxpayer to purposely mislead tax reporting, deceive tax authority, so that he/she can pay lower taxes than what is actual. In any case, tax evasion in all its forms is always against the tax law. Tax non-compliance may have various measures and they constitute the failure to submit tax return in the period stipulated or failure to submit at all, understatement of income, overstatement of deductions, and failure to pay assessed taxes in the data stipulated (Kasipillai & Abdul-Jabbar, 2006).

With regards to tax avoidance, it is said to happen when the ambiguities or impairment of tax law are leveraged to decrease duty tax, breaking liabilities, which indicates that tax avoidance is an unethical behavior (Slemrod & Yitzhaki, 2002). Nevertheless, tax avoidance is legal when the taxpayers' cleverness towards his affairs regulations is found suitable as to mitigate tax payment (Kasipillai *et al.*, 2003). There are tax avoidance behaviors that are based on the tax law loopholes, which made Selmrod (2004) and Alm *et al.* (1990) reached to the conclusion that tax avoidance is a legitimate action to minimize taxes due. However, if the taxpayers adhere to the tax owed, this indicates lower level of tax gap (monetary variance between collected and due tax) (Masagni *et al.,* 2014; Strader & Fogliasso, 1989). If majority of citizens practice tax evasion, it will be challenging for the state to provide public services in the form of education, electricity provision, security, road construction, and health services to the public at prices they can afford. In other words, the tax non-compliance issue is crucial to the policy makers as it shows lower revenues, which in turn, leads to significant government losses. Such non-compliance may also burden the honest taxpayers, which would lead to the latter's disrespecting the tax system for the burden. Majority of tax administrators direct efforts towards tackling and resolving tax non-compliance and determining the potential measures that can be used for its improvement.

2.2. Tax Complexity

Tax complexity was described by Jackson & Milliron (1986) as one of the primary tax compliance behavior drivers, with the main assumption being that taxpayers can evaluate different complex choices through the right assessment of the accessible information, from which they make selections to lead to the best outcome (Walsh, 2012). Therefore, tax complexity basically involves calculations, ambiguity, changes, excessive detail, forms and record-keeping (Long & Swingen, 1987). In the current study, tax complexity is defined as actions related with the issues faced by SMEs when it comes to sales tax law, and they include frequent changes, excessive details, multiple calculations and keeping detailed and special records.

Tax procedures and laws complexities add to the number of corrupted tax regime (Chander & Wilde, 1992). Taxes have transformed into a complex topic in majority of the countries, making tax complexity one of the crucial determinants of tax non-compliance and otherwise, and as such, the mitigation of tax

complexity could result in enhanced level of tax compliance behavior (Richardson, 2006a). Tax system complexity is therefore deemed to be one of the reasons behind tax payers' non-compliance which urges them not to comply intentionally or unintentionally (Saad, 2012). With lowered complexity of the tax system, it is expected that the taxpayer's behavior is enhanced towards tax payment and seeking consultants' assistance could be the answer to mitigating complexity and burden. In this regard, Alm *et al.* (2010) stated that tax offices can also enable lower ambiguity in the tax system through a direct engagement with the tax department.

In this line of study, Chau & Leung (2009) highlighted two dimensions of complexity in relation to tax compliance behavior and they are detailed calculations in tax owed determinations and confusing tax laws. Also, Faridy *et al.* (2014) stated that tax complexity generally found in tax systems are of three types' namely technical complexity, structural complexity and compliance complexity. This calls for the need to shed light on the tax system and to minimize tax complexity (Al-Mamun *et al.*, 2014).

Added to the above, tax complexity paves opportunities to adopt corruptive practices (Liu & Feng, 2015; Kiani, 2014). Stated clearly, increased complexity of tax laws may lead to increased level of tax non-compliance (Jackson & Milliron, 1986). Tax complexity thus leads to mitigating compliance as taxpayers attempt to opt for tax evasion and this could compound the issue if the taxpayer opts for intention non-compliance to avoid tax complexity (Kirchler *et al.*, 2008). On the whole, tax complexity reduction could be the answer to increasing tax compliance (Mansour, 2015; Warren & Mc Manus, 2007) as such complexity could lower compliance towards tax payment (Muche, 2014; Mc Clellan, 2013) and sometimes lead to the occurrence of tax mistakes (Mc Clellan, 2013).

Furthermore, a negative relationship was found by Cuccia & Carnes (2001) between tax complexity and the willingness to adhere with payment of tax, while Feld & Schneider (2011) revealed a direct positive relationship between tax complexity and tax non-compliance and shadow economy. Also, Abdul-Jabbar & Pope (2008) revealed that more complexities in tax and the repetitive adjustments in tax laws have adverse influence over SMEs. They indicated that increasing tax complexity will increase tax compliance costs and eventually tax non-compliance. Tax complexity was also evidenced to affect tax regime efficiency and performance (Sklenar & Burger, 2006), where in Africa, a significant negative relationship was found between tax complexity and tax compliance (Oyewole *et al.*, 2014).

Contrastingly, the relationship between tax compliance and tax complexity was revealed to be insignificant as supported by Morse *et al.* (2009), Fauvelle-Aymar (1999), Abdul-Jabbar (2009) and Azmi *et al.*, (2016b). Similarly, a simple tax system will not have the impetus to prevent non-compliance (Adam & Steven, 2002). However, other studies in literature reported a positive tax complexity-tax compliance relationship and these include Yahaya (2015) and Christie & Holzner (2006), while some others like Biabani & Amezani (2011) reported no relationship. A negative relationship was found by Woodward & Tan (2015) and Faridy *et al.* (2014) between tax complexity and tax compliance supporting the general assumption.

On the basis of the above discussion of literature findings, tax complexity can be described as one of the major determinants of tax compliance, but the relationship between the two still remains ambiguous and thus, this study is an attempt to shed more insight into it. Majority of studies of this caliber directed their focus on income tax, with sales tax compliance remaining relatively untouched. Tax complexity and tax compliance was also examined in the level of individuals and not SMEs. Therefore, there is a need to examine the relationship between tax complexity and sales tax compliance in the context of SMEs in Jordan. This study proposes the following hypothesis for testing;

H1: There is a negative significant relationship between tax complexity and tax compliance.

3. Methodology of research

The present study adopted a quantitative approach to examine the relationships among the independent and dependent variables, with the Jordanian Chamber of Industry (JCI) SMEs list as the sampling frame. Within the list, there are 17,849 Jordanian SMEs as of 2017 and based on Krejcie & Morgan's (1970) sampling selection, the current study's sample size should be 377. However, to prevent low rate of response, as in majority of SMEs studies, the sample size has to be increased as evidenced by prior literature that indicated 75% non-response rate in the Jordanian context (e.g., Lutfi *et al.*, 2017; Lutfi *et al.*, 2016).

On the basis of the above considerations, the sample size adopted by the study was 660 SMEs, with the targeted respondents being owners/managers of SMEs - they hold sufficient information on taxation and are authorized to reply to the relevant questions. The sample was exposed to probability sampling owing to the sampling type's enabling of less bias and more generalizability of findings (Zikmund *et al.*, 2013). Hence, the author conducted a systematic random sampling technique to select 660 respondents from the JCI list. The sapling interval was calculated using the equation (population/sample size), 1749/660, which is 27. At the onset, 27 were chosen, with sample elements numbered 27, 54 and 81, and so on until the last selected sample. In other words, the sampled element numbered 660. In a three months data gathering duration, 221 (33.5%) questionnaire copies were retrieved from the SMEs, among which 6 were incomplete and were dropped from analysis. Thus, the rate of response obtained was 32.5% as 215 questionnaire copies were deemed suitable for analysis. On the basis of Sekaran & Bougie's (2016) study, a rate of response of 30% and above is acceptable for a survey study and Baruch & Holtom (2008) stated that around 30% rate of response from the organizational level is deemed acceptable.

Furthermore, according to the suggestion provided by Hair *et al.* (2010), the number of observations to the number of latent variables should be 5:1 and hence, since the current study has one latent construct and the number of responses is 215, it is deemed acceptable. Also, in obtaining the least sample size, the power level desired, level of significance and number of predictors have to be determined (Green, 1991; Tabachnick & Fidell, 2007). As a consequence, the following formula is used to obtain the size required; N ≥ [50 + 8m], with m representing the number of independent latent variables, and N representing the number of cases. This formula was used to obtain the minimum required cases which were 58 (less than 215) and as such, the study's number of observations is acceptable and the analysis can be conducted.

4. Data analysis

In the present study, partial least square-structural equation modeling (PLS-SEM) was employed for testing the hypothesis, as suggested by majority of scholars, evidencing the efficient running of PLS-SEM in specific conditions (Hair *et al.*, 2016; Hair *et al.*, 2012). PLS-SEM was described by Becker *et al.* (2012) and Hair *et al.* (2011) as a convenient analytical tool when used with model containing higher-order latent variables, and when each latent variable has several observed variables.

More importantly, PLS-SEM can be used as an alternative to other models when the data characteristics do not meet regression assumptions (e.g., normality and sample size) as highlighted by Hair *et al.* (2011). Thus, the study examined the validity and reliability of the measurement model as suggested and Table 1 contains the values of composite reliability (CR) and Cronbach's Alpha (CA), which is 0.70, indicating internal consistency reliability of the variables. With regards to indicator reliability, the cut-off point establishment by several researchers (e.g., Hair *et al.*, 2017; Hair *et al.*, 2014) to confirm indicator reliability is 0.40. The study also conducted an assessment of the measurement model validity using Average Variance Extracted (AVE) and AVE for each variable listed in Table 2 exceed the threshold of 0.50.

Table 1. Composite reliability, Cronbach's alpha, ave and item loading

Latent construct	Items	Loading	CR	CA	AVE
Sales tax compliance (STC)	STC1	0.818	0.882	0.844	0.519
	STC2	0.819			
	STC3	0.726			
	STC4	0.695			
	STC5	0.665			
	STC8	0.643			
	STC9	0.659			
Tax complexity (TC)	TC2	0.836	0.735	0.827	0.516
	TC3	0.729			
	TC4	0.622			
	TC5	0.757			

From the above table (Table 1) the items values that ranged between 0.40 and 0.70 were dropped following Hair *et al.* (2014) suggestion to enhance the AVE values of the latent variables towards the

minimum accepted value. This necessitated dropping several items including STC6, STC7, STC10, STC11, TC1, and TC6. All the variables in the model explained over half of their indicators' variance, which shows sufficient convergent validity. Also, to confirm discriminant validity, square root of AVE was obtained and Table 2 shows that values of AVE square root of each variable exceed its correlation with other variables, ensuring discriminant validity. Thus, based on the figures tabulated, the measurement model's validity and reliability is confirmed. It can be concluded that the measurement model is appropriate for further analysis.

Table 2. Composite reliability, Cronbach's alpha, ave and item loading

Latent construct	Items	Loading	CR	CA	AVE
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	TC4	0.622			
	TC5	0.757			

The researcher then established the structural model to test and examine the proposed hypothesis. The path coefficients and significance level of each variable in the structural model was exposed to PLS algorithm and PLS bootstrapping method, with a resample of 5000. Table 3 presents the assessment of the structural model and it shows that tax complexity is negatively and significant related to tax compliance at (β = -0.156, t = 2.660, p ≤.0.01). This means an increase in tax complexity will lead to a decrease in sales tax compliance among SMEs and as such, hypothesis H1 is accepted. The study model managed to explain 22% (R^2) of the dependent variable, namely sales tax compliance, as evidenced by the large level of exploratory power.

Table 3. Result of hypotheses testing (Direct relationship)

H	Relationship	Path coefficient	T –Value	P – Value	Decision
H1	TC -> STC	-0.156	2.660	0.008*	Supported

Note: Significant at *p ≤.0.01 (one-tailed test)

5. Discussions

Prior studies dedicated to the tax compliance determinants including Richardson & Sawyer (2001), Fischer (1993) and Jackson & Million (1986) revealed that tax complexity is among the major significant determinants. Thus, in the present study, a negative and significant relationship was proposed between tax complexity and tax compliance (H1), and the obtained results supported the hypothesis. Based on this result, when the owners/managers of SMEs have to handle complex sales tax law, they are not as likely to be inclined towards complying with sales tax and thus, this is a logical outcome. This is aligned with the assumption of Fischer's model, which argues that for sales tax compliance to increase, the tax system has to be simple and easy to understand. Moreover, this finding is consistent with prior studies' findings which found a negative relationship between tax complexity and sales tax compliance among SMEs (e.g., Woodward & Tan, 2015; Faridy *et al*., 2014) and with former studies on tax behavior that focused on the same variables (e.g., Mansour, 2015; Muche, 2014; Oyewole *et al*., 2014; Brainyyah, 2013; Mc Clellan, 2013; Feld & Schneider, 2011; Kirchler *et al*., 2008; Jackson & Milliron, 1986).

In related studies including Isa (2014), Long & Swingen (1987) and Vogel (1974), the tax complexities reported to be faced by taxpayers and prevent their inclination to comply with tax payment include feelings of uncertainty, frequent changes in law, difficulty in records maintenance and tax documents. Majority of SMEs accepted that sales tax law complexity is what deters them from complying with sales tax payment (Faridy *et al.,* 2014) and it an also result in decreased tax compliance as the taxpayer attempts to gamble

more, and this may be compounded by the frustration of the taxpayer, which eventually leads to non-compliance (Alm *et al.,* 2010; Kirchler *et al.,* 2008). Moreover, sales tax law complexity influences SMEs more than major taxpayers and it leads to enhances costs of complying with tax laws, which ultimately decreases compliance (Faridy *et al.,* 2014). More importantly, in the Jordanian context, the tax system complexity coupled with lack of stability owing to tax laws changes leaves the taxpayers ambiguous to the provisions of tax law as a result of which they do not adhere to them – these are some of the major reasons behind non-compliance in Jordan mentioned by Nsour (2014). Hence, it can be concluded that tax complexity does contribute to mitigating compliance towards sales tax and it is one of the top issues that owners and managers of Jordanian SMEs are faced with.

6. Conclusions, policy implications, limitations and recommendations

Based on the above detailed discussion, tax complexity negatively influence sales tax compliance in the context of Jordanian SMEs and from the findings, the study has several significant contributions to both theory and practice related to taxation and accounting. First, this study contributes to accounting literature dedicated to sales tax compliance and tax complexity in developing nations, particularly Jordan. Only a few studies have been conducted to examine sales tax compliance and these covered the developing nations of New Zealand and Bangladesh (Woodward & Tan, 2015; Faridy *et al*., 2014). The present study is thus, to the best of the author's knowledge, is a pioneering study of this caliber, conducted in the Middle East, specifically Jordan. The study contributes to minimizing the gap in sales tax compliance literature.

Second, the findings of this study evidenced that high tax complexity leads to low level of sales tax compliance, which serves several implications to government agencies, tax authorities and SMEs. Owners and managers of SMEs accepted that tax complexity and high ambiguity in sales tax law negatively influences their compliance decision when it comes to sales tax and thus, it is logical to state that when perceiving tax system to be complex, SMEs sales tax compliance will drop. Hence, it is pertinent for owners and managers who are unaware or do not comprehend sales tax laws, regulations and procedures to be enlightened of the same. They need to be provided with tax education and assistance initiatives to assist their understanding of their obligations and entitlements when it comes to sales tax. In this regard, the government should collaborate and cooperate with the stakeholders via a participatory approach in order to reach suitable taxation system structure and sales tax law has to be simplified and made more understandable so that SMEs managers and owners will have no compliance issues.

Similar to other studies, the present study has its limitations that have to be highlighted during results interpretation. Such limitations may serve as opportunities for further in-depth studies. First, the study model explained 24% of the total variance in sales tax compliance, indicating the presence of other variables that can significantly shed light on variable. The remaining 76% of the variance could be determined by other latent variables that were not examined in this study and as such, future studies need to examine them and their influence on sales tax compliance – these may include tax knowledge, religion, external audit, tax auditor gender, and quality of tax service. This study may be deemed as the basis of sales tax compliance in Arab nations and the Middle East, particularly as it is focused on the context of Jordan, indicating that its theoretical framework can be employed in similar contexts. Nevertheless, because of the limitation in geographical area, future studies could extend the study model to other nations in the Middle East.

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