

## Factors Affecting Tax Compliance among Small- and Medium-sized Enterprises: Evidence from Vietnam

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### Abstract

Taxes are levied in almost every country, primarily to raise revenue for government expenditures. This study explores factors influencing tax compliance of small- and medium-sized enterprises (SMEs) in Vietnam. Data from 376 SMEs, who are business taxpayers, were collected through a researcher-administered questionnaire survey method. The results indicate that six groups of factors have significant impacts on tax compliance among Vietnamese SMEs. These groups include: Business characteristics (BC), Characteristics of accounting practices within organization (AP), Awareness of tax obligations (TO), Tax policy (TP), View on tax compliance (TC), and Probability of tax examination on taxpayer compliance (TE). Multivariate analysis was adopted; Cronbach's alpha coefficients were calculated, then, Exploratory Factor Analysis (EFA) was used. The findings show that, among these six factors, the most influential is Characteristics of accounting practices (AP). Thus, it is recommended that tax agencies should help SMEs improve their accounting skills and increase their knowledge by organizing training workshops and short courses on taxation. SMEs also need to have an adequate accounting system in accordance with principles and standards prescribed by the Tax Law. It is expected that this study can provide important insights and understandings to policy-makers, practitioners, academicians and other regulatory authorities in tax policy formulations.

**Keywords:** Tax Compliance, Tax Obligations, Tax Policy, Accounting Practices, SMEs, Vietnam

**JEL Classification Code:** G28, G41, K22

### 1. Introduction

Small- and medium-sized enterprises (SMEs) have been a noteworthy driver of economic development, being vital to most economies across the world, particularly in developing and emerging countries (Gherghina, Botezatu, Hosszu, & Simionescu, 2020). Many external and internal

factors influence the establishment, operation, growth and development of SMEs. The developed countries put SMEs in the focus of their economic strategies and programs with specific macroeconomic policies measures, such as targeted fiscal policy to SMEs, tax exemptions and special taxation schemes that directly affect the reduction of operating costs, improve liquidity and competitiveness of SMEs (Salehi, Khazaei, & Tarighi, 2019). In Vietnam, SMEs serve as a vehicle to create jobs for local communities. The government of Vietnam has identified and prioritized the development of SMEs as one of its strategic objectives. Despite the importance of these businesses for the country and regions, these businesses still face many challenges. One of the most onerous and time-consuming challenges is ensuring tax compliance. Tax compliance is defined as the preparation, submission and payment of taxes due within the specified time periods (Naicker & Rajaram, 2019; H. H. Nguyen, 2019).

Tax compliance and factors affecting tax compliance have been getting much attention in Vietnam. (Hoa, Lien, & Tuan, 2019; Nguyen, Pham, Le, Truong, & Tran, 2020). In general, tax compliance studies are based on three theoretical models:

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deterrence theories, economic and psychological models, and behavioral models. The method of tax compliance research based on behavioral theory can be considered as a significant advance in tax compliance studies. It is indicated that knowledge of compliance behavior goes far beyond deterrent factors and economic factors as described in previous theories. In order to study deeper tax compliance, researchers have included in their models new factors such as psychological, moral and social factors that influence tax compliance. Despite the growing number of studies on tax compliance, these results have remained inconsistent. One of the most important tasks of tax administration agencies is how to correctly identify the factors affecting the compliance of taxpayers, so that appropriate measures can be implemented to reduce tax evasion. This study helps to close the gap in the literature by identifying the factors that influence tax compliance among Vietnamese SMEs, introducing a research model, and proposing policy recommendations to increase tax payment compliance.

## 2. Literature Review and Hypothesis Development

Several factors have been identified in the literature that are claimed to have an effect on tax compliance costs incurred by business taxpayers. Based on findings of previous research studies, a number of factors are discussed to inform the hypotheses developed.

### 2.1. Business Characteristics

**Business size:** According to corporate law in Vietnam, SMEs are categorized into micro, small, and medium-sized enterprises having no more than 200 employees registered with the state social insurance scheme in a year and meeting either of the following two criteria: (1) total capital shall not exceed VND100 billion (about USD4.4 million) and (2) total revenue of the preceding year shall not exceed VND300 billion (about USD13.2 million). It was confirmed that, as the size of the business increases, the absolute external tax compliance costs also increase (Coolidge & Ilic, 2009; Fauziati & Kassim, 2018). Various studies have showed that there is a negative relationship between company size and compliance expenses relative to turnover. Small businesses bear higher relative compliance costs can partly be described because compliance costs can be considered fixed up to a certain extent. Whereas, large firms may enjoy economies of scale in their compliance expenses.

**Type of business ownership:** Kamleitner, Korunka, and Kirchler (2012) showed that there are three key aspects that distinguish small business owners' perceptions of their tax situation: (1) small business owners are likely to perceive

more opportunities not to comply than employed taxpayers; (2) they are more likely to experience a lack of meaningful taxation knowledge; and (3) they are more likely to face decision frames that render taxes as painful losses.

**Business age:** There is a simple link between the age of a business and internal tax. New businesses tend to generate small or low turnover with simple business structures. As businesses become more successful over time and their turnover grow, owners tend to favor more complex business structures, particularly incorporation, to minimize risk and tax. Also, younger businesses spent much time on tax compliance costs compared to older businesses. The possible reason was the inexperience of younger businesses in tax-related tasks, which made them spend more time on understanding the legislation. This line of argument suggests that an increase in the age of a business would be associated with increased experience which would, in turn, reduce the internal time spent on tax compliance tasks (Matarirano, Chiloane-Tsoka, & Makina, 2019)

**The corporate form of organization:** The various taxpayer groups have different characteristics, tax-compliance behavior, and levels of risk for loss of tax revenue, and should each be handled differently. Large firms where the imposed tax is progressive may break up their activity into multiple firms to keep their marginal tax rates low. Hence, it is necessary to understand and adjust the audit program accordingly for the taxpayer's (Goolsbee, 2004).

**Banking transactions:** The role of cash in facilitating tax evasion and money laundering needs to be investigated. Because taxpayers find it difficult to keep accurate records of all their transactions. In some cases, cash is being used by a small minority of people to hide or disguise their taxable income by not reporting, or underreporting, what they owe. Previous studies showed that, if banking transaction tax uses cash rather than electronic payment methods, there will be impacts on the economy in several ways, including the high cost of maintaining a large cash volume, easier tax evasion and expansion of grey and black markets (Baca Campodonico, de Mello, & Kirilenko, 2012). Therefore, the following hypothesis is proposed:

**H1:** Business characteristics have a positive effect on tax compliance of SMEs in Vietnam.

### 2.2. Characteristic of Accounting Practices within Organization (AP)

**The organization of the accounting apparatus (API):** The accounting system plays an important role in the company's organizational structure. The accounting system must provide accurate information for assessing performance, for identifying potential problem areas, and

for solving problems. A good accounting system will help managers complete tax compliance requirements quickly and easily. A lack of a good record keeping system that provides inaccurate and untimely tax information can result in stress for SME operators (Yong, 2011).

**Collecting, storing and processing accounting information (AP2):** Collecting and processing accounting information and data according to the subjects and contents of accounting work as well as the accounting standards and regimes (Wang, 2019). It was indicated that the method of recording, summarizing and validating of data about business financial transactions within organization has been related to tax compliance issues (Hollander, Denna, & Cherrington, 1999).

**Using an accounting information system (AP3):** An accounting information system helps organizations to gather, manage, store, interpret, process, and to retrieve financial data. Accounting software is one of the main parts of an accounting information system. Business accounting software can also produce the information used for tax compliance (Wang, 2019). On this basis, the following hypothesis is proposed:

**H2:** Characteristics of accounting practices have a positive effect on tax compliance of SMEs in Vietnam.

### 2.3. Awareness of Tax Obligations

**Proficiency of tax regulations (TO1):** The higher the level of understanding of taxation, the better the implementation of tax obligations, so that it can improve compliance. This is reasonable because often taxpayers do not carry out their tax obligations properly, not because of a desire to disobey, but the complexity of taxation sometimes forces them to disobey (passive tax resistance).

**Perceived fairness on tax system (TO2):** Fairness and equity of a tax system also impacts upon compliance levels. Perceived fairness of taxation has been found to strongly covary with compliance. Unfairness serves as rationalization and justification for tax non-compliance (Kirchler, 2007).

**Satisfaction with tax office (TO3):** It was declared that taxpayer's level of satisfaction with tax office service have influence their future compliance level (Ovute & Eyisi, 2014).

**The cost of tax compliance (TO4):** The cost of tax compliance is the amount of money that must be incurred by the taxpayer in implementing tax payments. So, the greater the cost of compliance to the taxpayer, the more likely the taxpayer will tend to perform noncompliance of taxes such as tax evasion or tax avoidance. Tax compliance costs include three major components, namely, monetary costs, time costs, and psychological costs to the taxpayers (Rantelangi & Majid, 2017). Accordingly, the following hypothesis is proposed.

**H3:** Awareness of tax obligations has a positive effect on tax compliance of SMEs in Vietnam.

### 2.4. Tax Policy (TP)

**Procedure of tax declaration (TP1):** Tax procedure rules govern tax compliance and administration, including taxpayers' obligations to file returns correctly and on time (EUROPEIA, 2007).

**Tax law (TP2):** If a tax law is clear and precise, taxpayers may view taking of a questionable deduction to be immoral. In turn, it is suggested that taxpayers who consider the taking of a particular deduction to be immoral will be inclined to not take the deduction. Conversely, if a tax law is vague and complex, taxpayers may be less prone to view the taking of a questionable deduction to be immoral. Such taxpayers may be inclined to take the deduction (Nugent, 2013).

**Mechanisms for encouraging tax compliance (TP3):** Encouraging tax compliance demands a careful understanding of how taxpayers think about and experience taxation (Karanja, 2014).

**Measures to support taxpayers (TP4):** In order to pay appropriate taxes small business owners must be knowledgeable about the different compliance measures and requirements (Kamleitner et al., 2012). Therefore, based on the argument previously described, the proposed hypothesis is as follows:

**H4:** Tax policy has a positive effect on tax compliance of SMEs in Vietnam.

### 2.5. View on Tax Compliance (TC)

**Tax rate (TC1):** It was showed that there is significant negative correlation between tax rate and tax compliance and tax rate has a negative effect on tax compliance (Mas'ud, Aliyu, Gambo, Al-Qudah, & Al Sharari, 2014).

**Taxpayers' rights and obligations (TC2):** Tax compliance is a state in which the taxpayer meets all its tax obligations and performs the taxation rights (Rahayu, Setiawan, & Troena, 2017).

**Companies' reputations (TC3):** Companies are always concerned with the impact of negative publicity on their reputation. It is believed that any negative publicity concerning tax compliance would affect the company's profitability (Lavermicocca & Buchan, 2015). Non-compliance can also affect the business reputation and invite ongoing scrutiny by the authorities. Hence, the proposed hypothesis is as follows:

**H5:** View on tax compliance has a positive effect on tax compliance of SMEs in Vietnam.

**Table 1:** The item measure

No	Factor (code)	Source
	<b>Business characteristics (BC)</b>	
1	Business size (BC1)	(Fauziati & Kassim, 2018)
2	<i>Type of business ownership (BC2)</i>	
3	Business age (BC3)	
4	<i>The corporate form of organization (BC4)</i>	
5	Banking transactions (BC5)	
	<b>Characteristic of accounting practices within organization (AP)</b>	
6	<i>The organization of the accounting apparatus (AP1)</i>	(Yong, 2011)
7	<i>Collecting, storing, and processing accounting information (AP2)</i>	
8	<i>Using an accounting information system (AP3)</i>	
	<b>Awareness of tax obligations (TO)</b>	
9	Proficiency of tax regulations (TO1)	(Ahmed & Braithwaite, 2005; Tusubira & Nkote, 2013)
10	<i>Perceived fairness on tax system (TO2)</i>	
11	<i>Satisfaction with tax office (TO3)</i>	
12	The cost of tax compliance (TO4)	
	<b>Tax policy (TP)</b>	
13	<i>Procedure of tax declaration (TP1)</i>	(Loo & Ho, 2005)
14	Tax law (TP2)	
15	<i>Mechanisms for encouraging tax compliance (TP3)</i>	
16	<i>Measures to support taxpayers (TP4)</i>	
	<b>View on tax compliance (TC)</b>	
17	<i>Tax rate (TC1)</i>	(Taylor, 2002)
18	<i>Taxpayers' rights and obligations (TC2)</i>	
19	<i>Companies' reputations (TC3)</i>	
	Probability of tax examination on taxpayer compliance (TE)	
20	Supervision on tax compliance (TE1)	(Hindriks & Myles, 2006)
21	<i>Probability of tax audit examination (TE2)</i>	
22	<i>Detection probability of tax evasion (TE3)</i>	
23	<i>Perceptions of burden of taxes (TE4)</i>	
24	Received benefits (TE5)	
	Tax compliance level (CL)	
25	<i>Completely paying all taxes (CL1)</i>	(James & Alley, 2002)
26	<i>Declaring all taxable income accurately (CL2)</i>	
27	<i>No tax debt (CL3)</i>	
28	<i>No tax-related penalty (CL4)</i>	



## 2.6. Probability of Tax Examination on Taxpayer Compliance (TE)

**Supervision on tax compliance (TE1):** Supervision is defined as a friendly and constant form of deterrence and interaction with the firms. This allows controlling for awareness of the auditing, while avoiding communication that is perceived as unfriendly. It is believed that the influence on the compliance of close supervision by the tax administration exists (Gangl, Torgler, Kirchler, & Hofmann, 2014).

**Probability of tax audit examination (TE2):** Both theoretical and empirical studies have documented that the risk of tax audit examination affects taxpayer behavior (Ayers, Seidman, & Towery, 2015).

**Detection probability of tax evasion (TE3):** Allingham and Sandmo (Allingham & Sandmo, 1972) indicated that tax compliance increases if audit probability (detection probability of tax evasion) or the level of penalty rises.

**Perceptions of burden of taxes (TE4):** Taxpayers always have the concern for the amount of taxes they pay. It was revealed that there is a strong statistical positive relationship between burden of tax and voluntary compliance (Abdul-Razak & Adafula, 2013).

**Received benefits (TE5):** Awareness of the benefits and services the state provides for the citizens from the revenues may increase the degree of tax compliance (Torgler & Schaltegger, 2005). Based on the description above, the proposed hypothesis is as follows:

**H6:** Probability of tax examination on taxpayer compliance has a positive effect on tax compliance of SMEs in Vietnam.

## 3. Research Methodology

### 3.1. Scales of Measurement

The data were collected in several successive steps. First, focus groups were conducted to explore the factors affecting tax compliance among SMEs. Next, focus groups pre-tested the questionnaire, and identified additional variables (that could affect the dependent variable) not present in the original survey instrument. A pilot survey was conducted, and reached 20 accountants and managers in different SMEs. Then, the instrument was modified, once again, for the final survey (see Table 1). The questions were asked on a 5-point Likert scale: (1) Strongly disagree; (2) Disagree; (3) Neither agree nor disagree; (4) Agree; (5) Strongly agree.

### 3.2. Sample and Data Collection

The method of sample size (N) calculation for multiple regression has been suggested by Green (Green, 1991) as:  $N$

$\geq 50 + 8p$ , where  $p$  is the number of independent variables. In this study, the number of independent variables is 5; therefore, the minimum value of sample size is 90. A total of 550 questionnaires were delivered between June 2018 and March 2020, and 376 valid responses were returned, representing a response rate of 68.36%.

### 3.3. Data Analysis

Multivariate analysis was adopted in the study. Multivariate analysis deals with the statistical analysis of data collected on more than one dependent variable. First, Cronbach alpha coefficients and item-total correlation were calculated. To be accepted, Cronbach's Alpha were greater than 0.7 the item-total correlations were more than 0.3 (Hair, Anderson, Tatham, & Black, 1998; Nunnally & Bernstein, 1999). Then, Exploratory Factor Analysis (EFA) was used to ensure validity of the scale and to explore factor structure. KMO must be larger than 0.5. If KMO is lower than 0.5 is not suitable, exploratory factor analysis should not be performed. Total variance explained must be greater than 50% and the factor loading must be greater than or equal to 0.5 within a factor (Gerbing & Anderson, 1988). In order to test the research hypotheses, the OLS coefficients at the 5% significance level are used.

## 4. Results and Discussions

### 4.1. Scale Validity

Before conducting the regression analysis, scale reliability and validity were examined. All of the calculated Cronbach's alpha coefficients are larger than 0.70, implying internal consistency of the items used. For all coefficients of corrected item, total correlation is greater than 0.3 (see Table 2). After assessing the reliability of scales by Cronbach's alpha, 24 items are used in the exploratory factor analysis (EFA). The first results of testing the validity of scales by the exploratory factor analysis shows that  $KMO = 0.835$ , Sig. (Bartlett's Test) =  $0.000 < 0.005$ . However, factor loading of BC4 (0.492) and TC3 (0.452)  $< 0.5$  and loaded at three factor groups. Thus, these two items were removed. The final results of the exploratory factor analysis are presented in Table 3.

The EFA results showed that the scale has adequate internal consistency. All KMO values are greater than 0.5, confirming a satisfactory factor analysis to proceed. Total variance explained is larger than 50% so that the correlation can be considered to be significant. Results also show that all factor-loading values are greater than the acceptable level (0.5).

**Table 2:** The results of reliability and validity test

Factor	Cronbach alpha (Number of observed variables)	Corrected item – Total correlation	KMO	Variance explained (%)	Min factor loading
Business characteristics (BC)	.744(5)	.489 - .536			.721
Characteristics of accounting practices within organization (AP)	.659 (3)	.500 - .814			.679
<i>Awareness of tax obligations</i> (TO)	.774(4)	.488 - .639			.651
Tax policy (TP)	.755(4)	.495 - .811			.768
<i>View on tax compliance</i> (TC)	.806 (3)	.564- .745			.671
<i>Probability of tax examination on taxpayer compliance</i> (TE)	.826 (5)	.524- .715			.701
<b>Tax compliance level (CL)</b>	<b>.750 (4)</b>	<b>.404- .611</b>	<b>.613</b>	<b>55.876</b>	<b>.615</b>

**Table 3:** The results of exploratory factor analysis (EFA)

Item	Component					
	1	2	3	4	5	6
TE2	.875					
TE4	.877					
TE5	.816			.200		
TE1	.763					
TE3	.712					
BC1		.828				
BC5		.795				
BC3		.708				
BC2		.668		.216		-.220
TP3			.774			
TP2			.738			
TP1	.207		.719	.222		
TP4			.711			.275
TC1				.806		
TC2				.784		
TC3				.775		.212
TO4					.836	
TO2					.823	
TO1	.227			.287	.725	
AP3						.789
AP1	.203					.688
AP2						.664

**Table 4:** Inter-item correlations

Variable	Mean	SD	CL	AP	BC	TO	TP	TE	TC
CL	3.710	.712	1						
AP	3.702	.807	.625**	1					
BC	3.423	.730	.485*	.315**	1				
TO	3.507	.769	.610**	.599**	.233**	1			
TP	3.534	.571	.583**	.465**	.313**	.508**	1		
TE	3.671	.630	.294**	.319**	.245**	.524**	.282	1	
TC	2.318	.579	.274**	.116**	.143**	.223**	.146	.123	1

**Table 5:** The regression analysis results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	-1.145	0.264		-4.339	0.000		
BC	0.147	0.046	0.135	3.091	0.002	0.931	1.076
AP	0.285	.046	0.284	6.182	0.000	0.797	1.255
TO	0.162	0.039	0.204	4.302	0.000	0.716	1.398
TP	0.365	0.061	0.273	6.079	0.000	0.810	1.234
TC	0.109	0.042	0.119	2.652	0.009	0.721	1.388
TE	0.251	0.044	0.265	5.860	0.000	0.788	1.267

## 4.2. Correlation Analysis

The analysis results show that mean values of effects of factors on tax compliance are varied between 2 and 3 on the five-points Likert scale. The standard deviation of factors is also small. Moreover, a low standard deviation indicates that the values tend to be close to the mean. According to the analysis, Characteristics of accounting practices factor has the largest influence on tax compliance (Mean = 3.702, SD = 0.807) and View on tax compliance has the smallest influence on tax compliance (Mean = 2.318, SD = 0.579). The results of correlation analysis show that all factors in the model are correlated (see Table 4).

## 4.3. Hypothesis Testing Results

The regression analysis with six independent variables (BC, AP, TO, TP, TC, TE) and a dependent variable (Tax compliance level - CL) was carried out and the results are shown in Table 5. It can be seen that all factors are statistically significant. It can be concluded that six factors including Business characteristics (BC), Characteristics of accounting practices within organization (AP), Awareness

of tax obligations (TO), Tax policy (TP), View on tax compliance (TC), and Probability of tax examination on taxpayer compliance (TE) have positive effect on tax compliance. Therefore, the hypothesis H1, H2, H3, H4, H5 and H6 are supported.

Among these six factors, the most influential factor is Characteristics of accounting practices (AP), because its standardized coefficient is highest ( $\beta = 0.284$ ). The factors following are Tax policy (TP) ( $\beta = 0.273$ ), Probability of tax examination on taxpayer compliance (TE) ( $\beta = 0.265$ ), Awareness of tax obligations (TO) ( $\beta = 0.204$ ), Business characteristics (BC) ( $\beta = 0.135$ ) and View on tax compliance (TC) ( $\beta = 0.119$ ).

## 5. Conclusions

The study has examined the influence of different factors on tax compliance. Through the literature review, six factors impacting on tax compliance were identified. These factors consist of 28 items (on a 5-point Likert scale ranging from “Strongly disagree” to “Strongly agree”) for measurement. The six influential factors of tax compliance in Vietnamese MSEs are Business characteristics (BC), Characteristics of

accounting practices within organization (AP), Awareness of tax obligations (TO), Tax policy (TP), View on tax compliance (TC), and Probability of tax examination on taxpayer compliance (TE). The most influential factor is Characteristics of accounting practices (AP) and the ordered followers are Tax policy (TP), Probability of tax examination on taxpayer compliance (TE), Awareness of tax obligations (TO), Business characteristics (BC) and View on tax compliance (TC). One implication is that tax offices and agency should propagate accounting skills that support tax compliance. SMEs also need to have an adequate accounting system in accordance with principles and standards prescribed by Tax Law. Our study has limitation, the study was mainly based on quantitative method and data collection was done over a short period of time, which does not provide insights over the long run. The study findings are expected to provide important insights to services' policy-makers, practitioners, academicians and other regulatory authorities in policy formulations.

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