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The Influence of Income Tax Law on the Relationship Between Demographic Factors and Income Tax Compliance in Uganda

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Abstract

The paper aims to examine the moderating consequence of income tax law in the association between demographic factors and compliance with income tax amongst owners of sole proprietorship small and medium enterprises (SMEs) in Soroti, Uganda. Descriptive and explanatory research designs were employed. Using proportionate stratified and simple random sampling techniques, the study selected 384 participants from the target population of 2,590 owners of sole proprietorship SMEs in Soroti, Uganda. Primary data was gathered using questionnaires and data was analysed using inferential (logistic regression) statistics with the help of Statistical Package for Social Scientists (SPSS). Hypothesis tests were done at a five percent significance level. Findings disclosed that income tax law significantly moderated the relationship between demographic factors and income tax compliance. The study draws attention to an issue that has been overlooked by many scholars. Aside from revamping key and associated literature on the study variables, this study identified a gap that had been neglected in betimes research. Income tax law as a moderator variable is an area that has been less covered. The findings of this study point to the importance of designing income tax laws that prompt individuals to comply with income tax obligations. The study recommends that the Ministry of Finance in collaboration with the relevant legislative bodies ought to evaluate the income tax law and particularly reconsider its complex nature.

Keywords: age, experience, level of income, filing of income tax returns

JEL classification: K34, H22, H25, J19

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1. Introduction

The paper originates from my PhD thesis on "demographic factors and income tax compliance amongst SMEs operated as sole proprietorship businesses in Soroti district, Uganda". The thesis specifically sought to establish the connection between demographic factors proxied as age, experience, gender, level of income, and tax knowledge of owners or managers of SMEs operated as sole proprietorship businesses in the district of Soroti, Uganda and their income tax compliance measured as filing of returns of income tax and prompt payment of income tax. The findings of the thesis revealed that age and tax knowledge significantly relate with income tax compliance, while experience, gender, and level of income of owners/managers insignificantly relate with income tax compliance among SMEs operated as sole proprietorship businesses in Soroti district, Uganda. This paper examines the influence of income tax law on the relationship between demographic factors (age, experience, and level of income) and income tax compliance. Specifically, this paper examines the influence of income tax law on the relationship between age and income tax compliance, experience and income tax compliance, and level of income and income tax compliance. As was the case in the thesis, in this study, income refers to the annual revenue that is earned by small and medium enterprises. In Uganda, small and medium enterprises are assessed with regard to the income tax on the total annual revenue that the enterprise earns from its operations.

All over the world, compliance with tax has become an elemental concern, as the number of persons enjoying to pay taxes literally diminishes. Globally, the performance of any sovereign state sizably pivots on revenues from taxes, which are used to finance expenditure on public goods and services. Studies indicate that the economic, social, and political development of a given state hinges on the total tax revenue engendered for delivery of infrastructure in that state, and the extent of compliance with tax by the nationals to promptly discharge their tax liabilities. In the meantime, though, revenue from taxes cannot be occasioned if taxpayers do not comply with the tax laws and discharge their taxes sufficiently and effectually. Regimes worldwide have come face to face with the challenge of resolving noncompliance with tax, markedly in developing states. Endeavours by states to generate revenue from tax are impeded by omnipresent tax evasion amongst taxpayers in most states. Revenue from tax lost from acts of tax evasion globally is projected to be over 3.1 trillion of United States dollars, which represents around 5.1% of the world's GDP (gross domestic product). The effect of failure to deliberately discharge tax to the state is more grievous in developing economies. By way of illustration, according to the Tax Justice Network Africa (2011), 138.5 percent and 97.7 percent of the healthcare budget is strayed to acts of tax evasion in South American and African economies, respectively. Nonetheless, the yearning to elude tax is rife in every nation and this occurrence has captivated several academics to explore the factors supporting it.

In Uganda, as is the case in the other East African countries, income tax is a tax charged on the annual revenue of an individual or business earned in a given year of income, and it generally applies to all types of persons who derive income, whether an individual, bodies of individuals or corporate entities (Income Tax Act of 1997, as amended). Resident persons are taxed on worldwide income, while non-resident persons are taxed only on income derived from sources in Uganda. The Income Tax Act further stipulates that income tax is imposed on three broad categories of income: business income, employment income, and property income. This study particularly considered business income as being income on SME businesses operated as sole proprietorship.

This study chose income tax law as the moderator variable, on the basis of the influence that income tax law has as one of the factors influencing income tax compliance. As stated by Youde and Lim (2019), income tax law as a variable strengthens the tax officials' power to raise income tax compliance. The author additionally states that measure and advancement of business depends on the expense to which it complies with income tax laws. The income tax law is an important variable in executing income tax policies that eventually help achieve income tax compliance.

2. Literature review

2.1. Theoretical review

- ***Deterrence theory***

The deterrence theory was advanced by Becker (1968) and is premised on handling the struggles of tax compliance. It is the traditional theory of tax compliance which is principally based on the postulation of fear of being detected and penalty accession (Allingham & Sandmo, 1972). Oladipupo and Obazee (2016) state that the deterrence theory stows insistence on incentives. The deterrence theory submits that taxpayers are noble utility maximisers who are influenced by their motives that are economic in nature, such as maximizing profit and detection probability. Consequently, taxpayers analyse surrogate compliance paths, for example, whether to evade tax or not, the possibility of being detected and the resulting repercussions, then pick the surrogate way that gives them maximum expected returns following tax after providing for risk. The theory holds that in order to improve tax compliance, non-compliance penalties need to be increased. However, Kornhauser (2007) argues that deterrence theory, that is hinged on the enforcement techniques by way of audit and penalties, explains only a small portion of real levels of voluntary tax compliance. The author additionally argues that this is because the theory has such a deficient explanatory power, as it postulates that the verdict to adhere is solely based on a cost-benefit review in which taxpayers rationally consider the advantages of non-compliance as opposed to the cost of getting detected and penalties as punishment.

- ***Legitimacy theory***

The legitimacy theory was proposed by Dowling and Pfeffer (1975) and it arose from the theory of political economy and from the organization legitimacy concept. Legitimacy is described as trusting or believing in government and its agencies, including the taxation authority, that operate for the good of the people. The legitimacy theory postulates that tax compliance is affected by the citizens' extent and level of trust on government together with its agencies (Kirchler *et al.*, 2008). Accordingly, it is assumed that compliance with tax should be more in a situation where citizens have a high level of trust and belief in government and its agencies than in a situation where citizens have a low level of trust and belief in government and its agencies. To a greater extent, tax compliance in African economies is so much determined by the element of political legitimacy.

2.2. Empirical review

In their study *Exploring the Influence of SMEs Demographic Profile on Tax Compliance Behaviour*, San *et al.* (2024) provide insights based on previous studies on determinants of tax compliance among small and medium enterprises in Malysia. Study results indicated that the age and level of income had significant influence on income tax compliance behaviour of small and medium enterprises.

Dhakal *et al.* (2023) carried out the study *The Impact of Demographic Factors on Tax Compliance: Evidence from Hetauda*. The focus of the study was to investigate what actually happens in the economy with the low tax compliance ratio in Nepal, which results in unexpected law tax revenue day by day. The study collected primary data through survey questionnaire from 300 selected samples and used quantitative research approach. The study results indicated that age had no influence on tax compliance, since the relationship was not significant.

Adegboye *et al.* (2018) conducted the study *Business Characteristics, Tax Administration and Tax Compliance by SMEs in Nigeria*, that purposed at examining relatively the tax administration and business characteristics' impact on tax compliance etiquette of small-scale enterprises in Nigeria. The study employed the empirical technique with the use of survey research design. The study used micro level data obtained from the world bank business survey data gathered in Nigeria between April 2014 and February 2015. The study revealed that experience encourages compliance with tax by small enterprises in Nigeria.

Andini and Rahmiati (2020) conducted the study *Tax and Compliance of Individual Taxpayers*. The purpose of the study was to obtain empirical proof about the association between the level of income and individual taxpayers' tax compliance by means of tax morale. The study had a qualitative nature and data was analysed using the technique of path analysis by means of SPSS software. The study applied a research sample size of 100 individual taxpayers picked from Pamekasan Regency. The study findings revealed that the level of income has a significant association with individual taxpayers' tax compliance through tax morale.

Pau *et al.* (2007) assert that the income tax law needs to be simple to enforce and apprehend. As a moderating framework for compliance with income tax, the law of income tax conveys out three features, including simple law of income tax, complex law of income tax, and moderate law of income tax. In conducting a relative study that involved seven economies, Strader and Fogliasso (1989) did a review about the complexity of income tax and the results suggested Japan, France, United Kingdom, Italy, and the United States all had income tax structures that are highly complex, that have a negative impact on compliance with income tax. Sweden and the Netherlands were considered to have less complex and moderate-income tax systems, which have a positive effect on compliance with income tax.

Bătrâncea *et al.* (2012) conducted the study *Tax Non-Compliance Behavior in the Light of Tax Law Complexity and the Relationship Between Authorities and Taxpayers* in Romania. The purpose of the study was to examine noncompliance with income tax behaviour under the effect of complexity of tax law and taxpayers' connection with tax officials. The study concluded that the complexity of the tax law does hinder the capability of the taxpayer to adhere to the tax law and encourages taxpayers to trail downwards the greasy incline of noncompliance with income tax.

Gambo *et al.* (2014) conducted a study on the complexity of tax and compliance with income tax in an environment of self-assessment in Africa. The study described tax complexity amongst other descriptions as realizing difficulty to read, apprehending and then interpreting the income tax law for it to be applicable in compliance with tax. The findings disclosed that tax complexity has a negative and significant effect on compliance with income tax in Africa. The study drew a conclusion that systems of self-assessment need be clear and simple.

Saad (2014) did the study *Tax Knowledge, Tax Complexity and Tax Compliance: Taxpayers' View*, that purposed to glance into the views of taxpayers on their extent of knowledge about tax and recognized the complexity of the income tax system. The study underlined that the complexity of tax comes about due to surged sophistication of the tax law. The results of the study insinuated that the tax system was heeded as complex by taxpayers and both tax complexity and tax expertise were deemed as variables that contribute to practices of income tax noncompliance by taxpayers.

2.3. Study objectives and hypotheses

To establish the influence of income tax law on the relationship between age and income tax compliance, we propose the hypothesis below:

H1: Income tax law does not have a significant influence on the relationship between age and income tax compliance.

To assess the influence of income tax law on the relationship between experience and income tax compliance, we propose the following hypothesis:

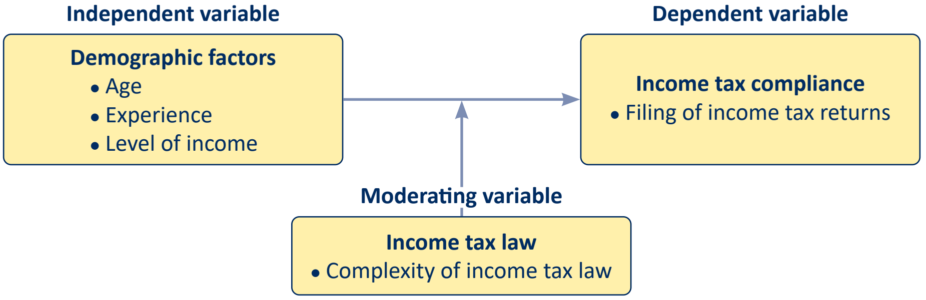
H2: Income tax law does not have a significant influence on the relationship between experience and income tax compliance.

To determine the influence of income tax law on the relationship between level of income and income tax compliance, the hypothesis is:

H3: Income tax law does not have a significant influence on the relationship between level of income and income tax compliance.

3. Conceptual framework

The conceptual framework confers the connection between the predictor, the moderating, and the response variable.



Conceptual framework

Source: Researcher, 2024.

Demographic factors are the predictor variable, and it is proxied by age, experience, and level of income. The response variable is compliance with tax on income, measured as filing of returns of income tax, while the moderating variable is income tax law measured as complexity of the income tax law.

4. Methodology

The study espoused explanatory and descriptive research designs. The study targeted a population of 2,590 SME owners, from which 384 respondents were sampled using proportionate stratified random sampling technique and simple random sampling technique. Questionnaires were given to the participants to gather primary data. Data analysis was done using inferential statistics that involved logistic regression to ascertain the moderating influence of the income tax law on the association between demographic variable and compliance with income tax.

4.1. Model specification

The study espoused the model logistic regression, where an assumption was made that taxpayers are either compliant with income tax given as $y_i = 1$ for success or noncompliant with tax on income given as $y_i = 0$ for failure. As put by Shiferaw and Tesfaye (2020), the attitude of income tax compliance is a random variable which is dummy and discrete in nature, and that can be estimated by the logit or binary logistic regression model. The study thus gleans the logit function out of the odds ratio as:

$$Log\ (odds\ ratio) = log\left(\frac{Success}{Failure}\right) = log\left(\frac{y_i = 1}{y_i = 0}\right) = \beta_0 + \beta X'_i \quad (1)$$

Equation (1) above can be expressed in probability terms and expanded by including a hypothetical error term as:

$$Log\left(\frac{p(y_i = 1)}{p(y_i = 0)}\right) = log\left(\frac{p(y_i = 1)}{1 - p(y_i = 1)}\right) = \beta_0 + \beta_1 AG + \beta_2 EX + \beta_3 LI + \varepsilon_i \quad (2)$$

In equation (2), β_1, β_2, and β_3 stand for coefficients of regression for the independent variables (AG for age, EX for experience, and LI for level of income), and ε_i is the disturbance error term that exemplify all variables of compliance with income tax not observed.

4.2. Testing of moderating consequence of the income tax law

The moderator variable in this study is income tax law given as TL. Consequently, to ascertain the moderation influence of the income tax law on the association between demographic variables and compliance with income tax, TL is brought in to the model as indicated in equation (3) below:

$$Log\left(\frac{p(y_i = 1)}{p(y_i = 0)}\right) = log\left(\frac{p(y_i = 1)}{1 - p(y_i = 1)}\right) = \beta_0 + \beta_1 AG + \beta_2 EX + \beta_3 LI + \beta_4 TL + \varepsilon_i \quad (3)$$

To measure the moderation influence of income tax law, income tax law is linked with demographic factors, leading to moderation equation shown in equation (4) below, same as applied in previous studies (Musau, 2018; Mas'ud *et al.*, 2014).

$$Log\left(\frac{p(y_i = 1)}{p(y_i = 0)}\right) = log\left(\frac{p(y_i = 1)}{1 - p(y_i = 1)}\right) = \beta_0 + \beta_1 AG + \beta_2 EX + \beta_3 LI + \beta_4 TL + \beta_5 (AG \times TL) + \beta_6 (EX \times TL) + \beta_7 (LI \times TL) + \varepsilon_i \quad (4)$$

Table 1. Moderation consequence on decision-making criteria

Analysis	Synopsis	Decision-making criteria
Income tax law as an explanatory variable	If TL has significant coefficient	Income tax law is an independent variable.
	If TL has insignificant coefficient	Income tax law can moderate the connection existing between demographic variables and compliance with income tax.
Income tax law as a variable that moderates	If the term of interaction (AG x TL, EX x TL, LI x TL) has significant coefficient	Income tax law moderates.
	If the term of interaction (AG x TL, EX x TL, LI x TL) has non-significant coefficient	Income tax law does not moderate.

Source: Researcher, 2024.

5. Results

5.1. Response rate

The study dispensed 384 questionnaires to all respondents who modelled the sample size. Out of the 384 dispensed questionnaires, 354 questionnaires were returned and received for analysis. This represents a response rate of 92.2 percent.

5.2. Hypotheses testing

- ***Test of the moderation consequence***

The study tested the null hypothesis that income tax law does not have a significant moderating consequence on the association between demographic variables and compliance with income tax amongst sole proprietorship SMEs owners in the district of Soroti, Uganda.

Table 2. Logistic regression of the moderation effect of income tax law

Income tax compliance	Odd ratios	Coefficients	Standard Error	t-value	p-value
Age of the taxpayer					
31 up to 50 years	0.12	-2.110	1.142	-1.85	0.065*
Over 50 years	1.07	0.072	0.092	0.79	0.433
Experience of the taxpayer					
6 up to 10 years	0.51	-0.672	0.515	-1.31	0.192
Over 10 years	0.99	-0.010	0.071	-0.14	0.886
Level of income					
100 to 360 million	10.36	2.338	1.140	2.05	0.040**
Income tax law	2.57	0.945	0.741	1.28	0.202
Constant	0.06	-2.826	1.632	-1.73	0.083*
Mean dependent variable		0.901	SD dependent variable		0.299
Pseudo R-squared		0.342	Number of observations		284
Chi-square		62.558	Probability > chi-square		0.000***
Akaike criterion (AIC)		134.325	Bayesian criterion (BIC)		159.868

*** p < 0.01, ** p < 0.05, and * p < 0.1.

Source: Study data, 2024.

The logistic regression results shown in Table 2 reveal a chi-square value of 62.558 and p-value of 0.000, which is less than 0.05. The findings submit a statistically significant model. They reveal that the model fits data well and is befitting in estimating compliance with income tax amongst owners of sole proprietorship SMEs in the district of Soroti, Uganda. The logistic regression results in Table 2 additionally indicate that when income tax law is regressed as a predictor variable it posts an insignificant relationship with income tax compliance at a 5% level of significance, having p-value of 0.202, which is atop 0.05. These results imply that income tax compliance is not directly affected by income tax law and, therefore, income tax law can significantly moderate the association between demographic factors and compliance with income tax amongst owners of sole proprietorship SMEs in the district of Soroti, Uganda.

The logistic regression results in Table 2 further show the regression coefficient for income tax law is 0.945, this implies that income tax law possesses a positive moderating consequence on the association between demographic variables and compliance with income tax amongst sole proprietorship SMEs owners in the district of Soroti, Uganda. Regression coefficient of -2.826 in Table 2 showing under constant stipulates the value of income tax compliance when income tax law and demographic variables are at zero. Consequently, the null hypothesis stating that income tax law does not have significant moderating consequence on the connection between demographic variables and compliance with income tax amongst sole proprietorship SMEs owners in the district of Soroti, Uganda is rejected by the study.

Table 3. Logistic regression model with a moderating consequence of income tax law

Variables	Category	Odds ratios	Coefficients	Standard Error	t-value	Wald chi-square	p-value
Age # income tax law	18-30 years	0.267	-1.320	0.671	-1.96	3.81	0.051*
	31-50 years	4.764	1.561	0.883	1.77	3.13	0.077*
	> 50 years	1.298	0.261	0.123	2.12	4.50	0.042*
Experience # income tax law	< 5 years	1.439	0.364	0.281	1.30	1.69	0.195
	6-10 years	1.363	0.310	0.210	1.48	2.18	0.621
	> 10 years	5.109	1.631	0.583	2.80	7.83	0.002**
Level of income # income tax law	< 99 million	0.270	-1.310	0.671	-1.95	3.80	0.051*
	100-360 million	8.398	2.128	0.131	16.24	263.87	< 0.0001***
Constant		0.907	-0.098	1.326	-0.07	0.00	0.941
Mean dependent variable				0.901	SD dependent variable		0.299
Pseudo R-squared				0.339	Number of observations		284
Chi-square				61.948	Probability > chi-square		0.000
Akaike criterion (AIC)				134.935	Bayesian criterion (BIC)		160.478

*** p < 0.01, ** p < 0.05, and * p < 0.1.

Source: Study data, 2024.

In determining the moderating consequence of the income tax law on the association between demographic factors and compliance with income tax, a multiplicative model was employed. To fulfil the multiplicative model, Table 3 shows that demographic variables were interacted with income tax law. The results in Table 3 indicate value of chi-square of 61.948, which is statistically significant (0.000) at a 5% level of significance. These results reveal that the model fits data well, hence the variables subsumed in the model justify significantly the dissimilarity in the compliance with income tax behavior amongst owners of sole proprietorship SMEs in the district of Soroti, Uganda.

The specific moderating effect of income tax law on considered independent variables was determined on the basis of the specific results after interacting the independent variables with income tax law, as indicated in Table 3. According to Taboga (2021), the value of chi-square read from the distribution table, subject to the craved extent of significance (5% for this study), is juxtaposed with the specific Wald chi-square results of interaction between demographic factors and income tax compliance. The author further asserts that upon comparison, the decision is then made. If the critical chi-square value is more than the Wald chi-square result, then the income tax law moderates insignificantly the relationship between demographic factors and income tax compliance, implying that the study fails to reject the null hypothesis. While if the critical chi-square value is less than the Wald chi-square result, then the income tax law moderates significantly the relationship between demographic factors and income tax compliance, implying that the study rejects the null hypothesis.

The interacting age of owners with income tax law outputted a Wald chi-square value of 3.81 (< 3.8415) with a regression coefficient of -1.32 for age cohort "18-30 years", stipulating a negative insignificant moderating effect for this age group. For age cohort "31-50 years", interaction outputted Wald chi-square value of 3.13 (< 3.8415) with regression coefficient of 1.56, stipulating a positive insignificant moderating consequence for this age group. Meanwhile, for age cohort "over 50 years", interaction outputted a Wald chi-square value of 4.5 (> 3.8415) with a regression coefficient of 0.261, stipulating a positive significant moderating effect for this age group. The study draws a conclusion that income tax law has a significant moderating consequence on the relationship between age and income tax compliance. This propounds that switches in compliance with income tax are notably explained by the influence of income tax law on the association between age and compliance with income tax.

The interaction experience of owners with income tax law outputted a Wald chi-square value of 1.69 (< 3.8415) with regression coefficient of 0.364 for experience cohort "up to 5 years", indicating a positive insignificant moderating impact for this group. For experience cohort "6-10 years", interaction outputted Wald chi-square value of 2.18 (< 3.8415) with a regression coefficient of 0.31, indicating a positive insignificant moderating effect for this group. Meantime, for experience cohort "over 10 years", interaction outputted Wald chi-square value of 7.83 (> 3.8415) with regression coefficient of 1.631, indicating a positive significant moderating consequence for this group. A conclusion is therefore drawn on the basis of these results, that income tax law has a significant moderating consequence on the relationship between experience and income tax compliance. This implies that switches in compliance with income tax are notably expounded by the impact of income tax law on the connection between experience and income tax compliance.

Results in Table 3 reveal that the interaction of income level of owners and income tax law outputted a Wald chi-square of 3.80 (< 3.8415) with a regression coefficient of -1.31 for level of income cohort "up to 99 million", indicating a negative insignificant moderating effect for this level. Meanwhile, level of income cohort "100-360 million" interaction outputted Wald chi-square value of 263.87 (> 3.8415) with regression coefficient of 2.128, that indicates a positive significant moderating consequence for this level. The study therefore draws a conclusion that income tax law has a significant moderating consequence on the relationship between income level and compliance with income tax. These findings propound that switches in income tax compliance are notably expounded by the influence of income tax law on the association between income level and compliance with income tax.

Table 4. Synopsis of the findings of moderating consequence of income tax law on demographic factors and income tax compliance relationship

Analysis	Coefficients	Results	Decision
Income tax law as an independent variable	Chi-square – 62.558 (0.000)	Significant	Model is fit
	Income tax law – 0.945 (0.202)	Insignificant	No direct effect
Income tax law as a moderator variable	Chi-square – 61.948 (0.000)	Significant	Model is fit
	Income tax law	Significant	Moderates
	Income tax law x Age	Significant	Moderates
	Income tax law x Experience	Significant	Moderates
	Income tax law x Level of income	Significant	Moderates

Source: Study data, 2024.

On the basis of the findings in Table 4, the null hypothesis stating that income tax law does not have a significant moderating consequence on the association between demographic variables and compliance with income tax amongst sole proprietorship SMEs in district of Soroti, Uganda is rejected by the study. This study exemplifies that the inclusion of a moderating variable in the model raises the explanatory power of the model.

6. Conclusions and recommendations

The study findings revealed that income tax law has a positive and significant moderating consequence on the association between demographic variables and income tax compliance. Therefore, the study draws a conclusion that whereas demographic factors affect income tax compliance, their effect is amplified by their interaction with income tax law. This conclusion highlights the importance of increasing tax education and tax awareness on matters such as reforms in the income tax law, maintenance of business records as required by the law and adequacy of income tax law. This can be done through initiatives, programs and trainings, so as to improve the taxpayers' knowledge of the income tax law. Since income tax law was found to significantly moderate the relationship between demographic factors and income tax compliance, this underscores the effect of the complexity of income tax law on the link between demographic variables and compliance with income tax amongst sole proprietorship SMEs in Soroti district, Uganda. Accordingly, the study makes recommendations that the Ministry of Finance needs to consider proposing to the relevant legislative bodies reforming certain sections of the income tax law to replace legalism and complex constructions with clear language that is easily comprehended by the taxpayers, Uganda Revenue Authority needs to advocate to the responsible bodies the inclusion of legal education in educational programs at all levels of study, so as to improve taxpayers' comprehension of the income tax law.

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