Tax compliance of financial services firms: a developing economy perspective

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Abstract

Purpose – The purpose of this study is to examine the contribution of tax morale, compliance costs and tax compliance of financial services firms in Uganda.

Design/methodology/approach – This study is cross-sectional and correlational and adopts firm-level data collected using a questionnaire survey of 210 financial services firms in Uganda from which usable questionnaires were received from 152 financial services firms.

Findings – Tax morale and compliance costs contribute up to 20.6 per cent of the variance in tax compliance of the financial services firms. Tax morale and tax compliance are positively and significantly associated. Results further indicate that compliance costs and tax compliance are positively and significantly associated. National pride and trust in government and its legal systems as dimensions of tax morale independently are significantly associated with tax compliance. Results also indicate that administration costs and specialist costs as dimensions of compliance costs individually are significantly associated with tax compliance.

Research limitations/implications – This study results should be generalized with caution, as they are limited to the financial services firms in Uganda.

Originality/value – Whereas there has been a number of studies on tax compliance in both developed and developing countries, this is the first study on the African scene to examine the contribution of tax morale and compliance costs on tax compliance of financial services firms in a single suite. It is unbelievable that the financial services firms, especially commercial banks which are highly regulated by the central bank in many developing countries, can afford to report tax payables year after year.

Keywords Tax compliance, Tax morale, Compliance costs, Financial services firms

Paper type Research paper

1. Introduction and motivation

This study reports the results of the study carried out to establish the contribution of tax morale and compliance costs on tax compliance of financial services firms in Uganda. Uganda's tax system is characterized with multiplicity of taxes and this has over time attracted criticisms. Recently, economists and the business community cautioned Uganda government against plans to raise taxes, as it would force Ugandans to evade taxes (Mugabe and Kulabako, 2016). Nkundabanyanga, Mvura, Nyamuyonjo, Opiso and Nakabuye (2017) argue that government's commitment to deliver on its promises enhances tax compliance in a developing country. Tax compliance involves timely reporting in form of filing returns and timely payment of taxes due (Kamleitner et al.; 2012; Musimenta *et al.*, 2017). During the

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1980s, structured research into tax evasion and non-compliance became widespread following the political concerns in the USA of an increasing "tax gap" (Tanzi and Shome, 1994). This trend has continued to exist as tax compliance is a major concern for all governments across the globe because a short fall in revenue collection often jeopardizes governments' ability to provide services like social amenities to her citizens. In European countries, 1000 billion euros is lost annually to tax evasion and tax fraud (European Commission, 2015). In Uganda, cases of low tax compliance are not uncommon, for example, Uganda Revenue Authority (URA) frequently registers revenue shortfalls like in the case of the financial year 2013/2014 where URA registered a revenue short fall of Uganda Shillings 475 billion (Budget speech, 2014).

Extant studies provide various explanations for tax compliance for example attitude (Alm *et al.*, 2006), isomorphic forces (Musimenta *et al.*, 2017), governmental effectiveness (Nkundabanyanga *et al.*, 2017), religiosity (Mohdali and Pope, 2014) and compliance costs (Faiday *et al.*, 2014; Muzainah *et al.*, 2004; McKerchar, 2003). Kamleitner *et al.* (2012) suggest perceived opportunity to evade taxes, knowledge requirements about tax and decision framing as key explanations of tax compliance in small businesses. Fischer *et al.* (1992) categorize major factors influencing individual tax compliance into four groups and these include demographic factors; opportunity for non-compliance; perceptions and attitudes; and tax system structure. Andreoni *et al.* (1998) also identified the following six families of factors influencing household tax compliance: income and tax rates; demographic and social factors; penalties and audit probability; prior audits; objective and subjective enforcement measures; and influence of tax practitioners. Alm *et al.* (2006) found that attitude (tax morale) is a possible explanation for tax compliance in Russia. This is supported by one of the earliest studies on tax evasion which explored a "tax mentality" concept which was presented by Schmolders (1959). This concept was based on the assumption that taxpayers have separate views with respect to looking after their self-interest as opposed to contributing to community interests (Devos, 2014). This implies that the more positive a taxpayer's attitude (morale) towards paying tax and working with the tax authorities, the greater their willingness to pay tax. More so, Alm *et al.*(1992) found out that compliance is greater when the individuals perceive some benefits from a public good funded by the tax payments. Therefore, understanding taxpayers' motivation and developing tax policies and strategies that can influence compliance brings more revenue and less administrative cost to the tax authority (Azmi *et al.*, 2008). However, according to the theory of reasoned action as suggested by Ajzen and Fishbein (1980), one's choice to pay tax depends on the morale he or she has and for that case, may not find it difficult to incur compliance costs as long as he or she is positive towards tax compliance.

Most of the tax compliance studies are common in the UK, USA and Asian countries, especially in Malaysia, Pakistan and China as well as Russia (Mohdali and Pope, 2014; Muzainah *et al.*, 2004; Ritsatos, 2014; Schmidt *et al.*, 2007 and Alm *et al.*, 2006) though in the recent past, there are compliance studies in Uganda (Musimenta *et al.*, 2017; Nkundabanyanga *et al.*, 2017). For instance, Mohdali and Pope (2014) studied the influence of religiosity on tax payers' compliance attitude using data collected from Malaysia. Ritsatos (2014) examined tax evasion on tax compliance with emphasis on the shift from the neo classical paradigm to behavioral economics in the USA. Tax morale according to Alm *et al.* (2006) involves social norms; trust in government in power and national pride. According to Alm *et al.* (1992), different reasons significantly affect taxpayer decision to comply, either by overweighting deterrence or placing utility in compliance. Taxpayers may value public goods offered by authorities, thus making taxation the only reasonable finance method for their own consumption of public goods (Ritsatos, 2014). As a result, taxpayers practice tax avoidance schemes (a series of legal economic actions) to reduce their tax liability. In doing so, an extra cost is sometimes involved which is the compliance cost. Compliance costs according to Muzainah *et al.* (2004) means the costs incurred in hiring specialists in tax advisory. The tax specialists have largely ignored the concerns of public interest in favor of commercialization and serving the interests of their clients (Shafer and Simmons, 2008). For this reason, they have facilitated aggressive tax avoidance schemes which neglect public interest. Studies linking compliance costs and tax compliance are uncommon among the existing literature in Africa as well as those linking tax morale and tax compliance. In this study, we provide an initial evidence on the contribution of tax morale and compliance costs to tax compliance of financial services firms in a developing economy like Uganda. This is achieved through a questionnaire survey of 152 financial services firms where accountants and auditors were the respondents. Results suggest that tax morale and compliance costs contribute 20.6 per cent of the variance in tax compliance. Also, tax morale and tax compliance are positively and significantly associated at 1 per cent. Results further signpost that compliance costs and tax compliance are positively and significantly associated at 1 per cent.

This research is thus motivated by the need to add on literature in the area of tax morale, compliance costs and tax compliance in the financial services firms, as existing literature is scanty on the Africa's experience. This research is further motivated by the need to recommend policy for tax compliance in financial service firms. Financial services firms are seen as the most regulated entities in the service sector in Uganda. Despite this fact, these firms have always reported in their financial statements tax payables year after year. This poses a question of why highly regulated entities cannot clear their tax liabilities to zero balance. In Uganda, taxpayers are required to lodge tax returns for each tax period within 15 days after the end of the period and payment is due on the date for furnishing of the return of income. The results indicated that financial service firms incur specialist costs which increase their operating costs. An increase in operating costs may require these firms to accumulate interest to pay for the additional costs. Delaying payment of taxes is one way of accumulating additional interest, as this money can be lent out for short term loans and acquire interest. Government needs better ways of ensuring that the sector's firms continue to register impressive results and, thus, tax compliance improvement.

The rest of the paper proceeds as follows: Section 2 is literature review where the theoretical foundation is discussed as well as the empirical literature which finally lead to the development of hypotheses. Section 3 explains the study's methodology, and Section 4 presents results. The next section is discussion of findings, while Section 6 is summary and conclusion.

2. Literature review

2.1 Theoretical underpinnings

In this study, we use theory of reasoned action and the utility theory. The utility theory, developed by Allingham and Sandmo (1972), assumed taxpayers to be 'utility maximisers' in decisions of tax reporting and compliance, where tax evasion was viewed as worthwhile if the financial gains purely outweighed the financial costs. Previous studies such as Murphy (2004), Tan (1998), Hite (1997) and Torgler and Murphy (2004) have argued that the human element plays a vital role in individual taxpayer compliance decisions. While the tax compliance literature has emerged from a wide variety of disciplines, there has been lack of consensus and agreement as to why people do or do not pay their taxes. Indeed, the tax compliance literature indicates that there are still many research gaps that need to be filled with respect to issues concerning tax morals, tax fairness and deterrence measures, for the likely improvement in overall taxpayer compliance. Tax compliance refers to the degree to which an individual or an organization complies with tax laws and regulations (Young *et al.*, 2016). Reinganum and Wilde (1985) argue that the existing system of income taxation is based on voluntary compliance because individual taxpayers *choose* to report their incomes, but this does not necessarily reflect their *true* income. Erard and Feinstein (1994) follow a different route in examining moral elements in tax compliance. They introduced shame and guilt into the utility of individual taxpayers and hypothesized that individual taxpayers will feel guilty and shameful if they under-report taxable income and are subsequently caught for non-tax-compliance. Andreoni *et al.* (1998) state that the economics of tax compliance can be viewed in the light of certain factors, either separately or in combination, including problems of public finance, organization structure, enforcement of laws and regulations, supply of labor and ethics.

The TRA assumes that individuals are rational and will make a systematic use of any available information available to take action. The theory further assumes that individuals will consider the implications of their actions before they decide to engage or not engage in a given behavior (Ajzen and Fishbein, 1980). The TRA model uses two major factors that are contributing to behavioral intention which are the attitude towards the behavior and subjective norm. According to Ajzen and Fishbein (1980), to gain deeper understanding of the factors influencing behavior, it is required to look into beliefs that individuals hold about themselves and their environment. Scholars such as Lujja *et al.* (2016) have used the theory of reasoned action to explain behavioral intention to adopt Islamic banking. We use the same theory to examine tax payer's attitude (tax morale) towards tax compliance. When tax payers have a positive attitude towards paying taxes, then tax compliance will be achieved. Scholars such as Nkundabanyanga *et al.* (2017) suggest that accountability is critical to luring tax payers into tax compliance. Tax payers will want to see what their taxes are used for before they can think of paying taxes. Musimenta *et al.* (2017) argues that there is that internal pressure that forces tax payers to comply and such pressure has a lot to do with influencing one's attitude or morale to comply with tax laws. If tax payers have a positive attitude towards tax compliance, then they will do everything possible to ensure that they comply, for example, they will be willing to incur compliance costs.

Having considered the TRA and the utility theory in explaining tax compliance, it is now suitable to gain an understanding of what other researchers have found in the area of tax compliance and how the existing literature has led to the development of hypotheses to guide this current study.

2.2 Tax morale and tax compliance

Not one person likes paying taxes (Frey, 2007), that is a fact leading to tax crimes and shadow economic activities all around the world. Notwithstanding all the efforts, embarked on by governments, to control this worldwide spectacle through the means of education, punishment and prosecution, the problem still occurs and cannot be ignored (Winnicki and Damm, 2013). Spicer and Lundstedt (1976) suggest that individual taxpayers' decisions about tax compliance and evasion are made based on their attitudes and the norms of their community. However, because of the lack of vital data, it is very difficult to take a real estimate of the regularity and extent of illegal activities. Most of the people involved in unlawful actions prefer to remain anonymous and, if possible, unobserved; hence, the estimation of the real scope of the problem may not be accurate (Schneider and Enste, 2000). Ho *et al.* (2013) found that majority of Chinese taxpayers agree with Lawrence Kohlberg's concept of the stages of moral development (Crain, 2005). Here, acceptable ethical behavior is identified as what is approved by in-group members and that binds members within the group to conform to the norms of the group. Therefore, if members from the primary group comply with tax rules and regulations, then a greater level of tax compliance by individuals is likely to be achieved. Chinese taxpayers are, therefore, less likely to be affected by common social and institutional factors such as perceived fairness among fellow taxpayers, taxpayers' evaluation of the tax system and the performance of the tax authority, as found in countries like the USA and the UK (Young *et al.*, 2016). Taxpayer confidence in parliament, government, justice system, tax administration has a valuable relation with tax morale (Cevat, 2014). If the level of this confidence is high enough, then individuals' loyalty to public administration would increase and so they would be more willingly to pay taxes.

There is a growing appreciation that there are prominent differences across both developed and emerging economies in their levels of tax compliance and that normal economic models of taxpayer compliance are powerless to explain these differences (Alm *et al.*, 2006). In a bid to explain these differences, researchers have recommended that the intrinsic motivation for individuals to pay taxes differs across countries and that it is these differences in tax morale across countries that may explain much of the differences in observed compliance behavior (Pommerehne and Frey, 1993; Alm *et al.*, 1995; Frey, 1997; Cummings *et al.*, 2004). A study conducted by Belkaoui (2004) in 30 countries indicate that tax compliance is highest in countries characterized by high economic freedom, important equity market, effective competition laws and low serious crime rate. The study results further show that powerful deterrent to tax evasion is the creation of tax morale or climate where citizens are guaranteed economic rights and safe lives. Where individuals can exercise their economic rights in terms of economic freedom, important equity market and effective competition laws, in a safe environment that improves their quality of life (Belkaoui, 2004), they are more prone to view tax compliance as less of a burden and more of a citizenship duty and this implies that moral considerations are highest where the tax morale is high. Further, Alm *et al.* (2006) concluded that taxpayer's judgment of the compliance of others has a strong impact on their willingness to pay taxes; that is, citizens seem more willing to comply as long as they believe that compliance is widespread and, thus, an accepted social norm. Another important factor is national pride, a variable that has not to our knowledge been shown previously to be a determinant of tax morale. Alm *et al.* (2006) further emphasize that there are significant regional differences in individuals' attitudes toward paying taxes. There are strong ethnic, economic and fiscal disparities across the Russian regions. Each region generally shows a diverse picture, with significant changes between 1995 and 1999 in tax morale. It is to be expected that tax morale can influence tax compliance. The foregoing discussion leads to the following hypothesis:

H1. There is a positive relationship between tax morale and tax compliance of financial services firms in Uganda.

2.3 Compliance costs and tax compliance

Compliance costs are taken to refer to the value of resources expended by taxpayers in complying with the requirements of the tax system and according to Binh and Glover (2002). Hansford and Hasseldine (2012) categorized compliance costs into external compliance costs and internal compliance costs. The external compliance costs are mostly the professional fees paid to external advisers. These fees (excluding VAT that firms can claim back) are classified as tax related, non-tax-related (including general accounting services, managerial advice and computerized accounting software assistance) and, finally, external payroll services. A study conducted by Faiday *et al.* (2014) on tax compliance of SMEs in

Bangladesh found out that compliance costs are associated with tax compliance. Faiday *et al.* (2014) further reports that the majority of the respondents admitted to have not considered compliance costs with VAT before and they usually calculate the costs related to tax for their own business planning and some respondents argued that they could not remember the exact figure about VAT compliance costs but felt that VAT compliance costs was higher compared to other taxes. Tax payers use tax professionals to represent them for a number of reasons. These reasons according to Devos (2012) include, a desire to lodge accurate returns mainly because of their lack of tax knowledge based on the complexity of the current tax law, a desire to minimize the tax they are required to pay, their fear of making a mistake and being penalized or just having a lack of time to complete their own return. Regardless of the reason(s), tax professionals currently represent 75 per cent of Australian Individual taxpayers and potentially have a large influence upon taxpayers' compliance attitudes and behavior. Still, Faiday *et al.* (2014) reported that most of the participants stated that they used a VAT adviser and/or accountant to assist with VAT which increased their VAT compliance costs. VAT advisors are considered as an effective figure with SME's tax compliance.

Complicated tax systems make it difficult and expensive for some tax payers to comply with policies and procedures owing to the costs associated with record keeping and the need for specialized information to comply with complex tax laws (Bird and Wallace, 2004) and, thus, the need to incur administration costs and specialist costs. This pushes small and medium enterprises like foreign exchange bureaus and other small and medium enterprises in developing countries including Uganda to operate outside official reporting systems (Kayaga, 2007), as the tax rules increase the labor costs which in turn provide a great incentive to avoid costs by working in the shadow economy of non-reporting (Schneider and De soto, 1989). Borrowing from economics, high compliance costs results in a burden resource costs on society, distorted production decisions, reduced investment, higher deficits, reduced tax equity and adverse price movements (Chattopadhyay and Das-Gupta, 2002).

The external and internal costs of compliance incurred by business taxpayers may be partly offset by tax compliance benefits (cash flow benefits, tax deductibility benefits and managerial benefits) and there is a significant relationship between compliance costs and tax compliance (Hasseldine *et al.*, 2012; Sandford *et al.*, 1989; Tran-Nam *et al.*, 2000). While the first two types of benefits have been incorporated in previous studies (Allers, 1994; Evans *et al.*1997), managerial benefits have generally been ignored. Managerial benefits are derived by the taxpayers, in particular small business taxpayers, where the more stringent record keeping requirements imposed by tax compliance result in the production of managerial accounting information available for decision-making and other business purposes (Sandford *et al.*, 1989; Lignier, 2006). Marcuss *et al.* (2013) found out that over half of the individual income tax compliance costs are associated with reporting and substantiating income, even for taxpayers with relatively simple sources of income. Taxpayers with simpler sources of income also tend to have fairly simple deductions and credits or none at all. Note that this analysis only considers the cost to the taxpayer. Based on the above discussion, it is expected that compliance costs have a strong positive relationship with tax compliance. The researcher can, therefore, hypothesize that:

H2. There is a positive and significant relationship between compliance costs and tax compliance of financial services firms in Uganda.

2.4 Control variables

The works of Bartov, Gul and Tsui (2000) recommend controlling for confounding variables to avoid falsely rejecting the hypothesis which in fact should have been accepted. For this reason, the researcher will control for age and size of the business. Acheampong *et al.* (2016) reported negative relationship between duration (age) of business operations and the compliance level at 1 per cent significance level. They argue that, though surprising, this negative outcome could be linked to the fact that small businesses who have been in operations for less than five years are less inclined to tax evasion than the well-established businesses. Thus, firms interested in sustaining their market reputation are more likely to accommodate the tax system as reputational risk is expensive for start-up firms. This implies that age of the business may have an effect on respondents' views. According to the descriptive studies of Sandford and Hasseldine (1992) and Collard and Godwin (1999), the cost efficient tax compliance strategy (for example outsourcing to an external adviser) depends on business size, with taxpayers on average choosing a cost-optimal compliance strategy. Eichfelder and Schorn (2009) also confirm that the compliance cost burden rises with business size, while the relative cost burden is remarkably higher for small businesses.

3. Methodology

3.1 Design, population and sample

The design of this study is cross-sectional and correlational. Cross-sectional research design is a type of observational study that analyzes data collected from a population, or a representative subset, at a specific point in time while correlational research design is a quantitative method of research in which there are two or more quantitative variables from the same group of subjects from which a relationship can be determined if it exists or not (Mukyala *et al.*, 2017). A population of 292 financial service firms was considered. The financial services sector is comprised of 25 commercial banks, 3 credit institutions, 3 micro-deposit taking institutions, 203 foreign exchange bureaus and 58 money remitters (Bank of Uganda, 2016). The financial services firms are best suited for this study since they are publicly interested entities with a population of 4 million functional bank accounts (Lumbwe, 2015). We used a sample of 210 firms using Krejcie and Morgan (1970) table of sample selection approach and used the stratified sampling and rotary method of selecting the subjects. Responses were solicited from Chief Accountants and Chief internal auditors of the financial services firms. From the unit of analysis, we got 152 firms (about 72 per cent of response). Usable questionnaires were obtained from 207 respondents (chief internal auditors were 65 (or about 31 per cent) and those from Chief Accountants were 142 (or about 69 per cent)). The male respondents were 139 (or about 67 per cent) and the female respondents were 68 (or about 33 per cent). 37 per cent had diploma qualifications, 54 per cent had undergraduate qualifications, while 17 per cent had masters degrees. 12 per cent were members of the Institute of Certified Public Accountants of Uganda (ICPAU), 6 per cent were members to Association of Chartered Certified Accountants (ACCA) and at least majority of the respondents had an undergraduate degree meaning that respondents were able to comprehend the questions asked in the questionnaire.

3.2 Questionnaire and measurements

Data were collected from respondents using a questionnaire with close-ended questions. We considered the recording of the responses in the questionnaire design (Sudman and Bradburn, 1982; Sekaran, 2000). There are two ways in which this can be done. One approach is to use an open-answer format which allows and encourages respondents to give their opinion fully and with as much nuance as they are capable (Sudman and Bradburn, 1982). However, this approach appeared inapplicable in this research where the intention was to calculate the mean ratings of the extent of agreement with each statement; in the alternative, we considered a closed-answer format which is easier to analyze (Sudman and Bradburn, 1982). The questions were anchored on a six-point Likert scale ranging from strongly disagree (1) to strongly agree (6), to allow the respondent register their degree of agreement. Questionnaires were self-administered and the exercise was carried out with in a period of three months to provide ample period to the completion of the questionnaire by the respondents. Table I shows the variables, their measures and reliability of scales (using Cronbach's alpha coefficient). The α coefficients suggested that the scales were sufficiently reliable.

3.3 Data management

We used exploratory factor analysis which according to Field (2009) is a technique for identifying groups or clusters of variables and has the utility of reducing a data set to a more manageable size while retaining as much of the original information as possible. Exploratory factor analysis was done by running a rotated component matrix, thereby reducing the questions to those that are more relevant to the study variables. Factor analysis was used to examine the attitude of tax payers towards tax compliance in the financial services firms in Uganda. Before executing the principal component analysis for our scales, we assessed the suitability of the data for factor analysis based on sample size adequacy, the Keiser – Meyer – Olkin (KMO) and Bartlett tests. The KMO and Bartlett's (1954) test of sampling adequacy was computed to ensure that factor analysis yields different and reliable factors (Kaiser, 1974). Field (2009) explains that KMO and Bartlett tests values range from 0 to 1. The following criterion is used to assess and describe the sampling adequacy. Below 0.5 = unacceptable, 0.5 to 0.7 = Mediocre, 0.7 to 0.8 = Good, 0.8 to 0.9 = Great and above 0.9 = Superb (Field, 2009; Hutcheson and Sofroniou, 1999 and Kaiser 1974). The results in Table II show that the KMO values for the predictor and outcomes variables are all above 0.5 which is acceptable. The KMO values for tax morale, compliance costs and tax compliance are 0.76, 0.76 and 0.81. Bartlett's test of sphericity in all scales also reached statistical significance (significant value of 0.000 for each scale). The table also reports the results of discriminant validity test of our measures using average variance extracted (AVE; Fornell and Larcker, 1981).

Data collected were cleaned, sorted, classified, coded and analyzed using statistical package for social sciences (SPSS) program. Data were entered, cleaned to identify the data out of range which was corrected after revisiting the affected questionnaire. Data were aggregated, as the unit of analysis is a financial services firm and in each, Chief Internal Auditors and Chief Accountants were the respondents. In this case, data were aggregated to get an overall picture of the variations in the study variables (Baydoun *et al.*, 2013). Pearson's Correlation coefficient was used to establish the relationship between the variables under study. Regression analysis was also conducted to determine the variance in the dependent variable that is explained by the independent variables.

4. Results

Descriptive statistics generated included means and standard deviations and are presented in Table III. The means and standard deviations are reported, as the means represent a summary of the data and standard deviations show how well the means represent the data (Nkundabanyanga *et al.*, 2014; Field, 2009). On a scale of strongly disagree (1) to strongly agree (6), the means for tax morale, compliance costs and tax compliance were 3.63, 3.77 and 4.18, respectively. The standard deviations for tax morale, compliance costs and tax

Table I.
Variables and their measurements

Global variable	Dimensions	Measurements	Definitions	Sample item scales
Tax compliance (Cronbach's $\alpha = 0.785$)	Timely filing of returns payment of tax. (Ritsatos, 2014; Braithwaite, 2009 and Musimenta *et al.*, 2017)	Respondents' mean rank of seven items of information included in the questionnaire on a six-point Likert scale	Tax compliance refers to the degree to which an individual or an organization complies with tax laws and regulations (Young *et al.*, 2016)	We disclose all the incomes earned for tax purposes
Perceived compliance costs (Cronbach's $\alpha = 0.714$)	Administration costs Specialist costs (Muzainah *et al.*, 2004)	Respondents' mean rank of nine items of information included in the questionnaire on a six-point Likert scale	Perceived compliance costs are the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities (Eragbhe and Modugu, 2014; Hasseldine *et al.*, 2012; Sandford, 1995)	We wish to improve the understanding of tax matters
Tax morale (Cronbach's $\alpha = 0.781$)	National pride Trust in government and its legal system (Alm *et al.*, 2006)	Respondents' mean rank of nine items of information included in the questionnaire on a six-point Likert scale	Tax morale can defined as the "intrinsic motivation to pay taxes" (Alm *et al.*, 2006; Torgler, 2003)	Our government acts in line with citizens' needs and desires

Tax morale items (Total Variance Explained = 55.9%)	Components: Trust in government (VE = 0.31)	National pride (VE = 0.25)
Our government acts in line with citizens' needs and desires	0.82	
We pay taxes because Government properly accounts for it	0.77	
We pay taxes because the legal system is straight forward	0.77	
We believe that tax revenue is spent properly	0.75	
Positive actions by Government are intended to improve taxpayers' attitudes and commitment to the tax system	0.59	
We pay taxes to develop our country		0.80
We are very proud operating in this country		0.77
We pay taxes because we love our country		0.76
This country gives us investment confidence		0.70
Compliance costs items (Total Variance Explained = 58.62)	Specialist costs (VE = 0.32)	Administration costs (VE = 0.26)
We wish to improve the understanding of tax matters	0.83	
We need expert opinion on special tax issues	0.81	
We need expert opinion about legislative change	0.79	
Tax consultancies are very expensive	0.68	
We wish to maximize deductions/tax offsets	0.59	
Payment of tax requires more skilled employees		0.80
Tax laws have become more complex		0.77
Filing returns is an additional cost to the entity		0.76
Payment of tax consumes a lot of time in lining up in the bank		0.70
Tax compliance items (Total Variance Explained = 56%)	Timely payment (VE = 0.38)	Timely filing of returns (VE = 0.18)
We pay the actual tax assessed	0.79	
We disclose all the incomes earned for tax purposes	0.76	
We pay tax in time	0.76	
We always have no outstanding debt with URA	0.74	
We provide accurate reports to URA for assessment of our tax liability	0.65	
Early tax payment is important	0.53	
We are always notified on the due date by URA to file returns		0.81
Whenever we delay to pay, URA reminds us		0.69

Table II. Exploratory factor analysis

Item	n	Min	Max	Mean	SD
National pride	152	1.00	5.75	4.19	0.78
Trust in government	152	1.00	5.75	4.19	0.78
Tax morale	152	1.11	5.11	3.63	0.71
Administration costs	152	1.57	5.14	3.54	0.66
Specialist costs	152	2.42	5.25	3.90	0.61
Perceived compliance costs	152	2.58	5.00	3.77	0.52
Timely filing of returns	152	2.20	5.80	4.04	0.67
Timely payments	152	1.80	6.00	4.32	0.73
Tax compliance	152	2.30	5.60	4.18	0.64
Firm age	152	0.00	1.00	0.98	0.14
Auditor type	152	0.00	1.00	0.84	0.37
Firm size	152	1.00	2.00	1.42	0.47

Table III. Descriptive statistics for independent and dependent variables compliance are 0.71, 0.52 and 0.637, respectively. Mean values for the study variables range from 3.54 to 4.32. According to Field (2009) when deviations are small compared to mean values, it is apparent that the data points are close to the means and, hence, calculated means highly represent the observed data. 98 per cent of the firms under study were aged above 5 years, while 83 per cent are audited by small and medium practitioners audit firms. In terms of size which was measured based on the number of employees, majority of them employed 5 to 50 employees and, thus, are medium-sized firms.

We then conducted the Pearson's correlation coefficient analysis to establish the relationships between independent variables and the dependent variable while controlling for firm age, firm size and auditor type of the firm. This provided the first-order tests for our study hypotheses. Tax morale and tax compliance of financial services firms in Uganda are positively associated ($r = 0.330^{**}$ and $p < 0.01$), providing initial evidence in support of *H1*, which states that there is a positive relationship between tax morale and tax compliance of financial services firms in Uganda. This finding implies that a positive change in tax morale will lead to a positive change in tax compliance. We also found a significant positive link between compliance costs and tax compliance of financial services firms in Uganda ($r = 0.352^{**}$ and $p < 0.01$), which is in support *H2*, which states that there is a positive and significant relationship between compliance costs and tax compliance of financial services firms. The implication of such a finding is that a positive change in compliance costs leads to a positive change in tax compliance. Correlation results further indicate that National pride and trust in government and its legal system as dimensions of tax morale are positively related to tax compliance at 1 per cent. Further, results indicate that specialists and administration costs too significantly relate to tax compliance positively at 1 per cent.

The correlation analysis results also show that, control variables that is, firm size, auditor type and firm age are not significantly related at the 1 per cent level. This implies that control variables do not confound the results of testing for the relationship between tax morale and tax compliance of financial services firms. Also, the relationship between compliance costs and tax compliance of financial services firms is not affected by the control variables. Results are reported in Table IV.

We also carried out multiple regression analysis to determine explanatory power of tax morale and compliance costs on tax compliance in financial services firms Uganda. The results in Table V show that the predictor variables explain 20.6 per cent of the variance in tax compliance of financial services firms in Uganda (Adjusted $R^2 = 0.206$). All the two predictor variables appeared to significantly explain variances in tax compliance indicating no variation with the zero-order correlation analysis.

5. Discussion

The results reported in this paper suggest that tax morale and compliance costs as possible explanations of tax compliance in Uganda. Tax morale was found to be significantly related with tax compliance. Additionally, National pride and Trust in Government and its legal systems as dimensions of tax morale are independently associated with tax compliance. This confirms earlier studies of Alm *et al.* (2006), Young *et al.* (2016); and Cevat (2014). Alm *et al.* (2006) suggested that national pride might positively contribute to cooperative behavior to participate in the financing of public services. Our results indicated that Ugandans take pride of their country and, hence, result into tax compliance. National Pride is love and devotion to one's country and reinforces the alliance of all citizens of the said country who share the same values. Taxpayer confidence in parliament, government, justice system, tax administration has a valuable relation with tax morale (Cevat, 2014). If the level of this confidence is high enough, then individuals' loyalty to public administration would

Table IV. Correlations between the dependent, independent and control variables

	1	2	3	4	5	6	7	8	9	10	11	12
National pride (1)	1											
Trust in government (2)	1.000**	1										
Tax morale (3)	*0.746***	*0.746***	*1*									
Administration costs (4)	0.201*	0.201*	0.107	1								
Specialist costs (5)	0.157	0.157	0.031	0.342**	1							
Compliance costs (6)	*0.210***	*0.210***	*0.073*	*0.718***	*0.900***	*1*						
Firm age (7)	0.158	0.158	0.134	−0.095	−0.055	−0.085	1					
Auditor type (8)	0.000	0.000	0.302**	−0.033	−0.100	−0.090	0.067	1				
Firm size (9)	−0.115	−0.115	−0.267**	−0.028	0.006	−0.008	−0.125	−0.526**	1			
Timely filing of returns (10)	0.215**	0.215**	0.249**	0.299**	0.308**	0.367**	−0.076	−0.046	−0.010	1		
Timely Payments (11)	0.288**	0.288**	0.349**	0.157	0.277**	0.278**	−0.055	−0.003	0.002	0.663**	1	
Tax Compliance (12)	*0.277***	*0.277***	*0.330***	*0.247***	*0.320***	*0.352***	*−0.071*	*−0.026*	*−0.004*	*0.905***	*0.919***	*1*

Notes: ** Correlation is significant at the 0.01 level (two-tailed); * Correlation is significant at the 0.05 level (two-tailed) increase and so they would be more willingly to pay taxes. Ugandans have a feeling that their country is important to them and thus they should pay taxes every time it is necessary for them to do so. This is in line with the theory of reasoned action where by once peoples' attitudes are positive towards tax compliance, they comply with the tax laws but if the attitude is negative, then there will be tax non-compliance. In improving tax morale of Ugandans, focus need to be put on providing infrastructures that are up to date and a proper governance and legal system. The country needs to give investment confidence to her citizens as well. Once the country is perceived as developing and in real sense, the country is seen developing, then there will be improved tax compliance. The country can be seen developing if there is an increased road network, railways, schools, health centers and telecommunications networks that are easily accessed. Access to these social services may be a different story altogether, but what is more important is their availability. The Government must thus ensure that when the citizens need and desire is availed and that the tax revenue is spent appropriately (to the satisfaction of the tax payer). Further, the legal system should be as clear and straight forward as possible. This finding provides more evidence for Alm *et al.* (2006) study whose results suggested that that there is a growing appreciation that there are prominent differences across both developed and emerging economies in their levels of tax compliance and that normal economic models of taxpayer compliance are powerless to explain these differences. Therefore, this confirms the fact that taxpayers are not simply independent utility maximizers rather individuals are recognized to contain an array of attitudes and beliefs which interact and respond to social norms (Devos, 2014).

The results also show that there is a significant relationship between compliance costs and tax compliance. This is further evidenced by the predictive potential of compliance costs of tax compliance as shown by the regression results. It is thus important that in Uganda, administration costs and specialist costs impact greatly on tax compliance. Administration costs involve time spent lining up in the bank waiting to pay taxes, hiring of skilled employees, filing returns, interpreting complex laws and being prepared for the new tax systems. In Uganda, every financial year, the tax laws are amended, as new taxes are introduced and old ones are removed based on the needs of people or the collection costs as well as Government priorities. Sometimes, new tax laws are amended if there are various sections of the same tax that has been revised. Specialist costs also affect tax compliance. The specialist costs include payment of fees to tax consultancies and hiring experts to give an opinion on how much tax should be paid by an entity given the entity's trade volumes and partners as well as the nature of goods being traded in. The existence of specialist costs in the financial service firms can explain the tax payables in their financial statements every financial year. Delaying payments is one way of financing the

Table V.
The regression model

	Unstandardized coefficients		Standardized coefficients			Collinearity statistics	
	B	Standard error	Beta	*t*	Significance	Tolerance	VIF
(Constant)	1.668	0.398		4.195	0.000		
Tax morale	0.276	0.066	0.306	4.210	0.000	0.995	1.005
Compliance costs	0.401	0.088	0.330	4.534	0.000	0.995	1.005

Notes: R = 0.466; R^2 = 0.217; Adjusted R^2 = 0.206; F change = 20.646; df1 = 2; df2 = 149; Durbin Watson = 2.208

entities. The accrued tax payables can be lent out as short term loans to accumulate interest which will service the consultancy fees, accrued during the filing of returns. The present study findings agree with those of previous scholars for example Faiday *et al.* (2014) found out that compliance costs are significantly associated with tax compliance of SMEs in Bangladesh. Similarly, complicated tax systems make it difficult and expensive for some tax payers to comply with policies and procedures because of the costs associated with record keeping and the need for specialized information to comply with complex tax laws (Bird and Wallace, 2004). The implication of the present study results is that for any firm in Uganda to comply with tax, administration and specialist costs will be incurred. This is a lesson to the tax authorities who should now think of training tax payers on how to handle tax matters.

6. Summary and conclusion

The purpose of this study was to find out the contribution of tax morale and compliance costs on tax compliance of financial services firms in Uganda. This was achieved through a questionnaire survey of 152 financial services firms representing a response rate of 72 per cent. Results indicate that both tax morale and compliance costs are significant predictors of tax compliance to the extent of 20.6 per cent. Results further indicate that tax morale is positively and significantly associated with tax compliance of financial services firms in Uganda. Also, compliance costs are positively and significantly associated with tax compliance of financial services firms in Uganda. National pride and trust in government and its legal system as dimensions of tax morale are positively related to tax compliance. Further, results indicate that specialists and administration costs too significantly relate to tax compliance positively.

Overall, the findings of this study have important insinuation for academics as well as practitioners and regulators. For academics, the results suggest that both tax morale and compliance costs are significant predictors of tax compliance of financial services firms. For Government, findings are important in that, government spending should be aimed at meeting the tax payers' needs and desires. Taxpayers expect their money to be spent on priorities especially on infrastructure and other critical areas of service delivery. The Uganda Revenue Authority should also focus on devising means of reducing this cost of compliance as it can encourage non-compliance or delayed compliance. One way of doing this is through timely and productive training of taxpayers on tax matters, especially on changes and complicated areas of the law. Second, increase on its publication of tax-related issues in the media. This could soften on the compliance costs and, hence, reduce on the tax payables reflected on the Balance sheets. As with any study, this is not without limitations, although it makes important contributions to the tax compliance literature of SMEs. First, this study was limited to financial services firms in Uganda, and it is possible that the results may only be generalized to financial services firms in Uganda. Second, given that it is a quantitative survey, responses could have been limited to those statements in the questionnaire. Finally, although an attempt is made at controlling for common method variance in particular by gathering data from different respondents, it may not be ruled out completely. As this study majorly focused on financial service firms, further research could be carried out in other sectors that are not highly regulated like Savings and Credit Cooperative societies and the hotel industry as well as in the manufacturing sector using the same methodological suite or even using a mixed methods methodology.

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