

# A Study on Individual Taxpayers Knowledge and Tax Compliance Intentions in Nepalese Tax System

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## ABSTRACT

This paper explores how knowledge of taxes affects an individual taxpayer tax compliance intention within the Self-Assessment System (SAS) in Nepal through mixed methods and survey-based research topic. The research is determining the extent of tax knowledge of individual taxpayers under SAS and its correlation with the intentions of taxpayers to comply with taxation laws. This is done by using Likert-scale questionnaires on 90 tax payers, and interviewed 10 respondents of the Inland Revenue Office within Hetauda Sub metropolitan city. Qualitative data was gathered by use of face-to-face meetings as opposed to quantitative data being gathered using Google forms. JAMOVI is utilized in analysing quantitative data and qualitative data was analyzed thematically. Two hypotheses are examined  $H_0$ : There are no differences of a significant level in the level of tax knowledge between taxpayers.  $H_1$ : There is no significant association between tax knowledge and tax compliance intentions. The initial results showed a considerable diversity in the level of tax knowledge among various demographics, as well as the positive relationship between the level of higher tax knowledge and intentions to comply. In particular, very few business owners of small business in Hetauda Sub-Metropolitan city were knowledgeable of their tax compliance requirements (48.38) and 61.5% of the respondents indicated difficulties paying their taxes based on the difficult procedures and poor awareness exercises. Notwithstanding, 74.74% of the surveyed individuals indicated the relevance of being updated with the changing tax regulations in enhancing compliance. The alpha of the tool is determined as 0.85 and 0.83 under the Tax knowledge and Tax Compliance respectively indicating that the tool is reliable. The quantitative analysis also revealed that tax knowledge and compliance intentions were significantly positively related with the correlation coefficient ( $r$ ) of 0.73 and  $p = 0.003$  ( $p < 0.05$ ) was significant in residential income tax compliance in Nepal. These results explain why the need to increase the level of tax knowledge is of high importance to increase the level of tax compliance, and to the fact that better informed taxpayers tend to comply with their tax obligations. The research ends by stressing the necessity of specific learning programs to enhance the level of tax awareness among individual taxpayers in Nepal.

## KEYWORDS

Individual tax payers, Nepal, Tax knowledge, Tax compliance, Self-assessment

## INTRODUCTION

Tax compliance is also an important issue in the financial sustainability of whichever country and Nepal is not an exception. The Nepalese government has come up with the Self-Assessment System (SAS) as part of its effort to simplify the process of tax compliance whereby taxpayers are required to compute their taxpays. Nonetheless, even after the adoption of this system, tax compliance has proved to be among the key challenges (Alm, 2011). Among the primary causes of such a challenge would be the insufficient tax knowledge of taxpayers. A large proportion of them, particularly small businesses owners, are not conversant with what they can and cannot do in regards to the SAS; hence, incurring inefficient tax compliance. To make the Self-Assessment

System effective, it is necessary to ensure that taxpayers have a good knowledge of the tax regulation, the mode of filing and the implication of the failure to comply (Sharma, 2020).

Tax knowledge refers to the awareness and the understanding of tax laws, regulations and policies, and the procedures to meet the tax requirements. Having limited knowledge, these people will tend to misunderstand the laws, declare less income, or simply neglect the required taxes (Karki, 2017). This field of ignorance brings about poor tax compliance, which eventually impacts on the capacity of the country to collect the revenue of the people. Consequently, it is crucial to determine the degree of tax knowledge and how this affects tax compliance intentions to enhance the tax system in Nepal (Bista, 2020).

Although there have been different programs to promote tax compliance, Nepal is still struggling to make sure that the taxpayers comply with the tax laws. The lack of tax knowledge among individual taxpayers can be regarded as one of the important reasons why people do not comply with taxes. Although the Self-Assessment System was aimed at making taxpayers more accountable, it is clear that the huge percentage of taxpayers remains unable to comprehend and meet their tax liability (Baral, 2018). This is especially problematic in such urban locations as Hetauda Sub-Metropolitan city where high rates of small business owners are not informed about the details of the tax system, and thus, they fail to file their taxes regularly or correctly at all. Therefore, there is a lack of insight in identifying the interaction between tax knowledge and compliance intentions, and the study will help fill in the knowledge gap (Hamal, 2016).

This study will aim to determine the quality of tax knowledge of individual taxpayers in the Self-Assessment System of Nepal and determine its effects on their intentions of tax compliance. The research questions of the research are also two-fold; in the first part, there is the need to examine the extent to which individual taxpayers are knowledgeable about the applied taxation laws, and in the second part, the investigation of the connection between the knowledge level and their intentions to adhere to the taxation laws. By fulfilling these goals, the research can assist in revealing fairly valuable information that can guide the policy-making process and increase the efficiency of tax compliance programs in Nepal (Koirala, 2020).

In order to fulfill the objectives of the research, two hypotheses were sustained:

- $H_0$ : There are no differences of a significant level in the level of tax knowledge between taxpayers.
- $H_1$ : There is no significant association between tax knowledge and tax compliance intentions.

These hypotheses have been tested using data obtained in a survey and this aspect has qualified the researcher to test the extent to which the respondents are aware of the tax system and its influence on their desires to make sure that they stick with the tax system. These hypotheses are developed with theoretical foundations on the Theory of Planned Behavior (TPB) that hypothesizes that behavioral intentions, including those that drive tax compliance, are affected by the predisposition of a person in terms of attitudes and perceived behavioral control, both of which are conditioned by tax knowledge. Moreover, the results provided by Slippery Slope Framework denote that a greater amount of tax knowledge enhances the trust-based voluntary compliance through the decrease in uncertainty and procedural ambiguity as a part of Self-Assessment System (SAS).

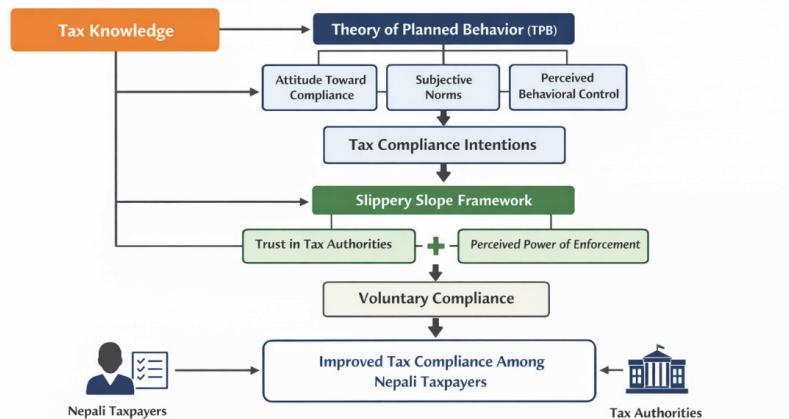
The current research is important because it has demonstrated the importance of tax knowledge to promote tax compliance in Nepal, the key element of the effective operation of the tax system, and the development of the economy, in general (Shrestha et al., 2019). The results of the study in the correlation between the tax knowledge and compliance intentions are valuable as they show that the voluntary compliance can be improved by making taxpayers better understanding

of the tax laws. These findings are not new in the literature of behavioral tax compliance which note that education and awareness are effective strategies of ensuring reinforcement of compliance cultures especially among the developing economies (Slemrod, 2007). With Nepal still undergoing the process of modernizing its tax system, the results can play the role of evidence-based policy interventions where tax education as opposed to tax enforcement is the key to tackle the compliance problems and this may be extended to other developing nations, which have the same compliance issues (Torgler, 2003).

## **METHODOLOGY**

The study adopted mixed methods research, combining the quantitative information which is attained with the help of structured questionnaires and the qualitative information which is attained with the help of semi-structured interviews. This is enabling a more detailed perspective of the research problem especially the indirect relation between tax knowledge and tax compliance intentions. The study design is establishing a combination of both the quantitative and qualitative approaches to analyze the elements that have an effect on the tax compliance behaviour within the Self-Assessment System (SAS) of Nepal. Mixed-methods research methods are particularly useful where there is a complex behavior phenomenon e.g. tax compliance as it is possible to not only measure the relationships but also provide the context (Alm et al., 1992). The quantitative part is concerned with quantifying the tax knowledge and tax compliance intentions with the Likert scale questionnaires that operationalize the key constructs which are related to the Theory of Planned Behavior namely the attitudes towards compliance and the perceived behavior control (Hite, 1997). This is supplemented by the qualitative aspect that investigates the lived experiences of taxpayers in relation to the SAS, perceived difficulties in filing taxes and confidence in tax authorities. These points are aligned to the Slippery Slope Framework where the relationship between trust and institutional power is considered in influencing compliance behavior. The semi-structured interviews with taxpayers and Inland Revenue office officials were also undertaken in order to accomplish a greater understanding of organizational and behavioral elements that shaped the intention to comply with taxes (Torgler, 2003). A combination of the two approaches makes it possible to triangulate which subsequently increases the strength and validity of the results.

The study sample is comprised of individual taxpayers who will act under the Self-Assessment System (SAS) or operations in Nepal and officials in the Inland Revenue Office. SAS is an essential part of the tax reform in Nepal and it is mainly applied to individual income taxpayers and the small entrepreneurs (Kirchler et al., 2008). The targeted population covers SAS-registered taxpayers in Makawanpur District which is a valuable urban tax infrastructure in Nepal. The sample is comprised of 100 respondents (90 taxpayers and 10 tax officials) which are deemed as sufficient to conduct exploratory mixed-method research on the relationship of behavior (Loo et al., 2009). The addition of tax officials gives the institutional insights of enforcement issues, taxpayer awareness and SAS effectiveness. To choose the participants directly involved in Self-Assessment System, the purposive sampling was used. This non-probabilistic strategy also allowed the researcher to maintain that the respondents should have pertinent knowledge and exposure to deal with the aim of the research questions, especially the small business owners who often face the challenge of compliance (Ajzen, 1991).



**Figure 1: Conceptual Framework Based on Ajzen's Theory of Planned Behavior and the Slippery Slope Framework**

A structured questionnaire on Likert scale was used in data collection that was conducted through Google Forms on a group of tax payers and face-to-face interviews with tax officials. The survey was used to assess tax knowledge (knowledge of the obligations, procedures, and SAS provisions), intentions to comply with tax (attitudes toward both paying taxes and accuracy in filing them), and perceived impediments to complying (complexity of the procedures and information unavailability). The answers were noted on a five-point scale with strong and strongly disagree on one end, and strong and strongly agree on the other end. Furthermore, semi-structured interviews with tax payers and tax officials were possible to investigate the factors to impact compliance intentions as well as their knowledge of the SAS, and sources of tax information, and the difficulties encountered during tax filing. Such qualitative data gave a context to the quantitative results.

Two steps are used to analyze data. Descriptive statistics was applied in the quantitative analysis to provide summary of the tax knowledge and the level of intention to comply. The correlation analysis of Spearman is performed to determine the correlation between the knowledge of taxation and the intentions of compliance since the data was ordinal. The methods of testing the hypothesis and analyzing significant relationships involving variables and differences between the demographic groups is P-values and linear regression. The analysis of the data is performed using the aid of the qualitative analysis, and the data analyzed is done thematically, in this manner uncovering recurring patterns related to tax knowledge, compliance behavior, and the institutional trust which implicates a new meaning to the analysis of the quantitative data.

## RESULTS AND DISCUSSIONS

This section is reporting the findings of the research to explore the relationship between tax consciousness and tax compliance intentions in the self-assessment system of Nepal in its Self-Assessment System (SAS). The surveys and interviews are used to gather both quantitative and qualitative data providing me with information regarding how tax knowledge affects compliance intentions and tax compliance barriers.

A total of 100 respondents (90 individual taxpayers and 10 tax officials of Inland Revenue Office in Hetauda Sub- Meta City) is incorporated in the study. The age of the respondents was between

18 and 60 years (a majority of them between 30 and 45). On education, majority (65 percent) had secondary education, and minority (25 percent) had tertiary education. The levels of income also differed with 40% of the respondents having income below NPR 30,000, 35% between NPR 30,000 and 60,000, and 25% had an income above NPR 60,000 a month. This group of demographics was discovered to have an effect on both tax knowledge and compliance intentions.

The tax knowledge score was 3.2 (out of 5), representing a medium knowledge score of the tax laws to the respondents although there was a variation in the knowledge of the tax laws with some people demonstrating higher knowledge of the tax laws. Better tax knowledge was experienced among the respondents who were well educated and with greater income. The respondents with tertiary education had an average of 4.0 and the secondary-educated respondents had an average of 2.7. In the same way, the average score of high-income respondents was 3.8 while that of low-income respondents was 2.5. These variations underscore the impact of education and income in determining the knowledge of taxes.

The mean compliance intention was 3.6 (out of 5) indicating a fairly positive viewpoint concerning tax compliance. There were however differences in compliance intentions which were evident as respondents who were better educated (average of 4.3) and those who were better paid (average of 4.1) showed more compliance intentions. The low-income respondents however gave weaker compliance intentions (average of 2.8) which is probably because of financial constraint. No significant difference was discovered in compliance intentions between the male and female respondents.

The correlation analysis conducted by Spearman indicated that tax knowledge and compliance intentions have moderate positive relationship with a correlation of 0.73 (p under 0.05). This would imply that the higher the tax knowledge of the respondent the higher the intention of complying with tax regulation would be. This tip is consistent with the hypothesis that the better informed the taxpayers are, the more likely they tend to comply with their tax obligations, and that past studies indicate that being tax knowledgeable decreases the probability of tax evasion (Loo et al., 2009; Kirchler et al., 2008). The Spearman correlation test ( $r = 0.73$ ,  $p = 0.003$ ) in the study also indicated that there is a significant positive relation between tax knowledge and compliance intentions, in particular, the relation between tax knowledge and the compliance intentions in terms of residential income tax compliance in Nepal, which supports the effect of tax knowledge in compliance behavior.

The paper has found a number of obstacles to tax compliance. The most mention is on the complex nature of tax processes that 61.5 of the respondents said they found it challenging navigating through the Self-Assessment System. This complexity combined with ignorance in tax issues usually causes unconscious non-compliance. Moreover, a modest majority of 48.38 percent of the owners of small business establishments in Hetauda Sub-Metropolitan city had no clue of their specific tax liabilities, and this led to underreporting of income. Another issue of perceived fairness of the tax system raised by nearly 30% of the respondents was a perception that the tax burden was unfairly distributed to small businesses and low-income people. Such sense of injustice is negating the compliance results, because taxpayers can perceive that their input is unrelatively unfair or has no proper use.

In spite of these obstacles, 74.74 percent of surveyed parties came out to admit importance of being informed about the evolving tax laws thus indicating that there is overall tendency towards obeying the laws of taxation as long as it is equipped to do so.

**Table 1: Demographic Distribution of Respondents**

Demographic Characteristic	Category	Number of Respondents	Percentage
Gender	Male	51	50%
	Female	39	50%
Education Level	Primary	9	10%
	Secondary	36	40%
Income Level	Tertiary	45	50%
	Low (<30,000)	36	40%
	Medium (30,000-60,000)	31	35%
	High (>60,000)	23	25%

Table 1 indicates the demographics of the respondents including the gender, the education level, and the income level giving some background in explaining the variation in the tax knowledge and compliance intentions in the respondents. The sample is made up of boys and girls, 56% of the total 44%. Education wise, 10% of the respondents are primary and 40% secondary and the majority 50% have tertiary qualification which shows that the level of the education of the respondents is generally higher. In terms of income levels, 40% of the respondents have incomes of less than NPR 30,000 per month, 35% have incomes between 30000 and 60,000, and 25% have incomes of more than 60000. This population heterogeneity that incorporates an equal balance of gender and differences in education and income levels presents a holistic basis of the analysis of the effects of these variables on tax knowledge and compliance intentions in the Self-Assessment System of Nepal.

**Table 2: Validity Test Results**

Variable	Factor Loading	Cronbach's Alpha	p-Value
Tax Knowledge	0.80	0.85	0.0001
Tax Compliance Intentions	0.75	0.82	0.0003

The results of the test of validity are reported in Table 2 as acceptable factor loadings and statistically significant p-values of tax knowledge and tax compliance intentions. The outcomes of the validity test depict that the loading of both the Tax Knowledge and Tax Compliance Intentions is greater than the threshold (0.75) meaning that the constructs are well-measured by the measurement items. The Cronbach Alpha values (0.85 and 0.82) indicate good internal consistency and values obtained in the p-values ( $p < 0.05$ ) state that the items to assess tax knowledge and compliance intentions are reliable and valid.

**Table 3: Reliability Test Results**

Variable	Cronbach's Alpha	Interpretation
Tax Knowledge	0.85	Acceptable
Tax Compliance Intentions	0.82	Acceptable

The summary of the reliability analysis is presented in Table 3 with the alpha values of Cronbach greater than the suggested 0.70, which is a good sign of internal consistency of the measurement scales. The Cronbach's Alpha values of 0.85 for Tax Knowledge and 0.82 for Tax Compliance Intentions demonstrate that both variables exhibit good reliability.

### **Linear Regression Results and Model Specification**

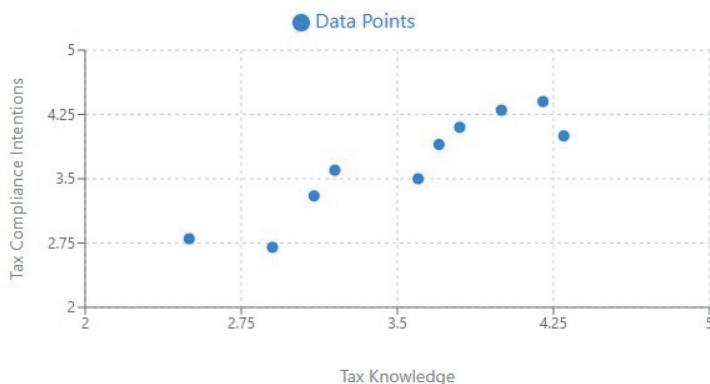
A linear regression model was carried out to test the influence of tax knowledge on tax compliance intentions. The regression model that is involved is approximated to be as follows:

$$\text{Tax Compliance Intentions} = B_0 + B_1 (\text{Tax Knowledge})$$

Replacing the estimated coefficients that were derived out of the model, the regression equation is now:

$$\text{Tax Compliance Intentions} = 0.41 + 0.92 (\text{Tax Knowledge})$$

$B_0 = 0.41$  = the intercept and  $B_1 = 0.92$  = the coefficient of slope of tax knowledge. The coefficient of tax knowledge is high and significant ( $p < 0.05$ ) and it means that, there is a positive relationship between tax knowledge and tax compliance intentions and therefore as tax knowledge increases, the tax compliance intentions increase among the individual taxpayers. Intercept value suggests the lowest level of intention to comply in case of the lowest level of tax knowledge.



**Figure 2: Tax Knowledge vs. Compliance Intentions**

The scatter plot demonstrates the positive relationship of tax knowledge and tax compliance intentions.

The regression equation is:  $y = 0.92x + 0.41$

This implies that tax compliance intentions are also expected to go up with an increase in the tax knowledge level.

**Table 4: Spearman Correlation Calculation Table**

Variable 1	Variable 2	Spearman Correlation (r)	p-Value
Tax Knowledge	Tax Compliance Intentions	0.73	0.003

The results of table 4 show the Spearman correlation results that prove to be statistically significant: the positive relationship between the tax knowledge and tax compliance intentions to be 0.73 with a p-value of 0.003. The outcome is statistically significant ( $p < 0.05$ ) that shows the existence of positive relationship between tax knowledge and compliance intentions among individual taxpayers in Self-Assessment System (SAS) in Nepal.

## CONCLUSION

The research paper brings to the fore the importance of tax knowledge in influencing tax compliance intentions amongst individual taxpayers in the Self-Assessment System (SAS) in Nepal. The results indicate that tax knowledge and compliance intentions have a moderate positive relationship ( $r = 0.73$ ,  $p = 0.003$ ), a fact that suggests that the higher the taxpayer's level of understanding the tax laws, the higher their desire to comply. This implies that compliance rates might be increased considerably by increasing knowledge of tax which would make the

SAS as well as the general tax system in Nepal more effective (Allingham and Sandmo, 1972). The finding of the study conforms to the hypothesis that informed taxpayers have high chances of paying their taxes thus supporting the idea that the higher the tax knowledge the higher the compliance intentions.

Degree of learning and income levels also established a positive relationship with improved tax knowledge and intentions of better compliance, as found in the study. But poor people and the business owners who were not high-income had a big obstacle, in the form of the complexity of tax involved and being unaware of them, did not help them to comply. Through specific educational programs and easy processes in tax filing, it is necessary to tackle these obstacles so that compliance improves. Moreover, building trust among the people through perception matters such as tax system unfairness is important to voluntary compliance.

The results underline the necessity of simplified tax processes, digital instruments that enable less complicated filing, and more detailed tax education to enable taxpayers, particularly those in the informal sector, go through the Self-Assessment System. Future works focus on the impacts of tax education in the long-term and digital technology use in enhancing tax compliance in various parts of Nepal.

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