

Unravelling the Effects of Perceived Severity of Penalties on Income Tax Compliance for Tanzanian Small and Medium Enterprises

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<https://dx.doi.org/10.4314/ajasss.v6i2.1>

Abstract

Enhancing tax compliance behaviour among SMEs will improve revenue collection, thus enable government to finance social-economic welfare of its citizens. Therefore, this study investigated the effects of perceived severity of penalties on individual income tax compliance among Tanzanian Small and Medium Enterprises. A cross-sectional survey of 382 SMEs was conducted in six tax regions of Tanzania – Kinondoni, Kariakoo, Temeke, Mtwara, Singida and Tabora, selected using simple random technique. Descriptive and Partial Least Square Equation Modelling were used for data analysis. The findings of the study show that perceived severity of penalties has positive and significant effects on the decision of the individual to register with the tax system and make correct declaration of income. On the other hand, it has a positive, but insignificant effect on the decision of the taxpayer to pay taxes within due dates. The findings imply that penalties are more effective in enhancing compliance behaviour at the registration and declaration than on payment stage. Thus, government through the Tanzania Revenue Authority should continue to use penalties and other administrative measures including inter alia, taxpayer education, good customer care and services, to enhance tax compliance behaviour among SMEs.

Keywords: Tax Compliance, Small and Medium Enterprises, Severity of Penalties

1.0 INTRODUCTION

Globally, Small and Medium Enterprises (SMEs) are the most common type of business (Martinez *et al.*, 2023). For example, in the USA, OECD and middle-income countries, they are not only the predominant businesses but also primary drivers of employment, Gross Domestic Product, and innovation and hence significantly contribute to generation of tax revenue (Tahir *et al.*, 2018; Martinez *et al.*, 2023).

Similarly, in Sub-Saharan Africa, SMEs are notably engines that drive economic development through job creation, employment, generating revenue to the government in the form of taxes and Gross Domestic Product (Muriithi, 2017; Tusubira, 2018). In Tanzania, this sector comprises 60% of the Gross Domestic Product and it is a fast-growing economic sector offering significant numbers of employment, wealth creation (Muriithi, 2017; ILFS, 2021), and a growing alternative to formal employment (Tusubira, 2018), thus potential in generating domestic income tax (Supriyadi, 2017).

However, despite SMEs' economic potential, their tax compliance behaviour is still a challenge (Mkenda *et al.*, 2023). Most of the SMEs in Tanzania are classified under individual taxpayers in the tax code (Machogu and Amayi, 2013). Tax compliance behaviour refers to registration in the tax system, making correct declaration of income and paying taxes within the due dates (OECD, 2004).

Taxes on income of the SMEs' individual taxpayers contribute an average of 3.2% to the total direct taxes (URT, 2022), thus contributing to the lower tax-GDP ratio. The country's average tax-GDP ratio is 11.6% in the last decade, which is below that attained by some of the other sub-Saharan Africa for example Botswana [22.2%], Burkina Faso [16%], Rwanda [15.1%] and Kenya [15.6%] (Semboja & Msafiri, 2022). Moreover, according to the IMF and the World Bank, a tax-GDP ratio of 20% is the minimum required to achieve Millennium Challenge Goals (Mkenda *et al.*, 2023).

Enhancing tax compliance behaviour among individual taxpayers will improve revenue collection and upgrade tax-GDP ratio (Appiah *et al.*, 2024). In pursuing this strategy, the Government of Tanzania introduced administrative procedures to simplify compliance to tax laws, notably presumptive tax system and block management system (Semboja, 2017; Mkenda *et al.*, 2023). These measures aimed to capture more taxpayers in the tax net and expand the tax base, hence increasing revenue collection (Mkenda *et al.*, 2023). However, these measures have not fully achieved this objective (Mkenda *et al.*, 2023).

Therefore, in addition to the administrative measures, the government uses penalties such as interests and fines to enhance tax compliance behaviour among individual taxpayers (Semboja, 2017; Semboja&Msafiri, 2022). Imposition of penalties increases cost of tax evasion, hence reducing net benefits that would accrue to the taxpayers as a result of non-compliance (Allingham and Sandmo, 1972). According to the prospect theory, the perception on the severity of the penalties enhances compliance behaviour of taxpayers (Tusubira, 2018). This refers to the extent to which taxpayers estimate penalties to erode their profitability in business (Luttmer & Singhal, 2014). Therefore, perceptions on the severity of penalties are expected to influence future compliance decisions of the taxpayer (Mascagni *et al.*, 2018).

Experimental studies in the developed countries concluded that perceived severity of penalties has positive and significant influence on compliance behaviour of taxpayers (Del Carpio, 2014; Dwenger *et al.*, 2016; Kleven *et al.*, 2016; Bergoloet *al.*, 2018; Hopes *et al.*, 2021). Conversely, other studies conclude the influence is positive but insignificant (Dewi *et al.*, 2022). However, the environment or tax systems in the developed countries are different from those in the developing countries (Hordonic, 2018) and experiments are set in the hypothetical conditions where actual behaviour may not correctly be displayed (Slemrod, 2019). Hence, there is paucity of empirical studies on influence of perceived severity of penalties on compliance behaviour in the developing countries.

Moreover, in the developing countries with fragmented tax systems, taxpayers may demonstrate variations in behaviour across the cycle of compliance in stages of registration, declaration of income and payment of taxes (Msangi, 2015; Heriel& Vaishali, 2024). Thus, an understanding on how imposition of the penalties rectifies non-compliance behaviour in each specific stage in the compliance cycle is necessary in the design of optimal tax policy (Deyganto, 2018).

However, few empirical literatures on tax compliance available in developing countries including Tanzania have focused on the general impact of the penalties on the general compliance behaviour without reference to the specific stage in the compliance cycle (Mahangila, 2015; Supriyadi, 2017; Mascagni *et al.*, 2018; Fjeldstaldet *al.*, 2020; Hereil and Vaishal, 2024).

Therefore, previous studies present knowledge and empirical gaps, as the influence of perceived severity of penalties on compliance behaviour of individual taxpayers at the specific stages of its cycle is not clearly known. Tax

laws provide penalties having varying severity to enforce taxpayers to register into the tax system, make correct declaration of income and pay taxes within due dates (TAA, 2015).

Against this backdrop, this study answered three basic research questions; One, what is the influence of perceived severity of penalties on decision of the individual to register with the tax system? Two, how does perceived severity of penalties influence decision of taxpayer to make correct declaration of income? Three, what is the influence of the perceived severity of penalties on the decision of taxpayers to pay taxes within due dates?

In order to address the aforementioned research questions, the study employed quantitative approaches. A cross-sectional survey of 382 individual taxpayers was conducted in these six tax regions of Tanzania – Kinondoni, Kariakoo, Temeke, Mtwara, Singida and Tabora. Descriptive and Partial Least Square Modelling were used for data analysis. The findings showed that perceived severity of penalties has positive and significant influence on compliance behaviour at the registration and declaration stages, and positive but insignificant influence at the payment stage of the compliance cycle.

The remainder of this paper is organized as follows; Section 2 presents Literature Review, Section 3, Research Methodology, Section 4, Findings and Discussion and, finally, in Section 5 we present Contributions, Limitations, Areas for Future Research, Conclusions and Recommendations.

2.0 LITERATURE REVIEW

2.1 Theoretical Literature Review

The present study employed economic deterrence and prospect theories in explaining the decision of an individual to comply with tax laws (Allingham and Sandmo, 1972; Kahneman and Tversky, 1979). The theories are notable in explaining the compliance behaviour of taxpayers (Tusubira, 2018).

2.2 Economic Deterrence Theory

The economic deterrence theory assumes that individuals make economic decisions so as to maximize benefits and minimize costs (Allingham and Sandmo, 1972). In the context of tax compliance, decisions to evade taxes will depend on the benefits and costs associated with such evasion (Allingham and Sandmo, 1972). Imposition of penalties on tax evaders is expected to increase the costs of tax evasion and reducing the benefits thereof (Slemrod, 2019). Therefore, it is expected that imposing severe penalties on SMEs which evade taxes will enhance their compliance behaviour (Slemrod, 2019).

2.3 Prospect Theory

Prospect theory assumes that individuals will always make future decisions that minimize loss and maximize gains (Kahneman & Tversky, 1979). Their decisions are based on the known reference parameters or their perceptions on the parameters (Kahneman & Tversky, 1979). In respect of tax compliance, taxpayers will decide to evade taxes carefully so as to minimize loss which might occur from this decision (Tusubira, 2018). Imposition of penalties on tax evaders is expected to minimize benefits on tax evasion and increase costs or loss to the tax evaders (Tusubira, 2018). Hence, decision to evade taxes is based on their perceptions on the severity of penalties (Luttmer and Singhal, 2014).

The theory predicts that, perceived severity of penalties enhances tax compliance behavior (Tusubira, 2018). When taxpayers perceive penalties to be severe, they will comply with tax laws (Msangi, 2015). Otherwise, if penalties are perceived to be lenient tax evasion will be higher (Tusubira, 2018). Experimental studies conducted by Kleven *et al.*, (2016) and Mascagni *et al.*, (2018) concluded variations in the perceptions of severity of penalties influences compliance behavior of the taxpayer.

2.4 Empirical Literature Review and Hypothesis Development

Effects of Perceived Severity of Penalties on Registration in the Tax System

Most of the tax authorities across the globe use self-assessment system in the administration and collection of the domestic taxes (Remaliet *al.*, 2018). Self-assessment system requires the taxpayer to voluntarily register with the tax system, make correct declaration of their income and pay taxes within the due dates as specified by the tax authority (Remaliet *al.*, 2018). Non-compliance with the requirement to register in the tax system is punishable under tax laws (Remaliet *al.*, 2018; Ghani *et al.*, 2020).

Msangi (2015), examined the effects of the severity of the penalties on tax compliance behavior in Tanzania and concluded that severe penalties have positive and significant effects on decision of eligible taxpayers to register with the tax system (Deyganto, 2018; Rahman *et al.*, 2024).

Conversely, Verboon and Van Dijke (2011), concluded that application of severe penalties does not enhance compliance behavior of the taxpayers. Severe penalties may be perceived as unfair and a burden to the taxpayers (Wijaya, 2023). Likewise, Engida & Baisa, (2014), and Ropikiet *al.*, (2023), concluded that severe penalties have no impact in enhancing taxpayers to register with the tax system. Antithetically, Blank (2014) recommended the use of collateral

penalties to complement those in the form of financial or monetary to enforce SMEs to register in the tax system.

Conclusively, the effect of perceived severity of penalties in enhancing compliance of taxpayers to register with the tax system is still debatable (Wijaya, 2023). Hence, the study developed the following hypothesis;

H1: Perceived severity of penalties has positive and significant effects on taxpayers' decision to register with the tax system

Effects of Perceived Severity of Penalties on Correct Declaration of Income

Taxpayers are obliged to declare their income correctly to the tax authority and on the risk-based approach; the authority may examine or audit some of the returns submitted by the taxpayers to ascertain its correctness (Remaliet *al.*, 2018). It is expected that more severe penalties will enforce taxpayers to declare their income correctly to the tax authorities (Davos, 2009; Rahman *et al.*, 2024).

A study conducted by Davos, (2009) among individual taxpayers in Australia concluded use of the financial or monetary penalties creates disutility to the tax evaders and enhances their compliance behavior. Similarly, experimental studies conducted by Kleven *et al.*, (2016) in Denmark, Borgolo *et al.*, (2018) in Uruguay, Del-Carpio, (2014) in Peru concluded that perceived severity of penalties has significant and positive effect on the decision of taxpayersto make correct declaration of their income. Moreover, survey studies conducted by Deyganto (2018) in Ethiopia, Msangi (2015) in Tanzania and Alam (2020) in Bangladesh had similar conclusions.

However, Engel *et al.*, (2019) concluded that perceived severity of penalties has no impact on the decision of taxpayer to declare their income correctly to the tax authority. Similarly, other studies conclude the effect of perceived severity of penalties on the decision of taxpayers to make correct declaration of income is moderated by social norms and trust to the government (Koume`, 2019; Triandani and Apollo, 2020). Perplexingly, Slemrod (2019) concluded that severe penalties may cause taxpayers to use creative accounting and tax avoidance practices, hence under-declaring their income to tax authorities.

Conclusively, the effect of perceived severity of penalties on decision of taxpayers to make correct declaration of their income is still debatable. Hence, this study developed the following hypothesis;

H2: Perceived severity of penalties has positive and significant effects on taxpayers' decision to make correct declaration of their income

Influence of Perceived Severity of Penalties on Payment of Taxes within due Dates

In accordance to the predictions of the economic deterrence theory, imposition of penalties on the taxpayers who fail to settle their tax liabilities within the prescribed time is expected to eliminate economic benefits that would accrue to taxpayers as a result of such non-compliance (Allingham and Sandmo, 1972).

A significant number of empirical studies evidenced that a severity of penalties leads to enhancement in tax compliance behaviour (Alabede, 2011; Dyganto, 2018; Ahmad, 2018; Alam, 2020; Fjeldstaldet *et al.*, 2020; Hoopes *et al.*, 2021; Dewi *et al.*, 2022). However, these studies were conducted in different tax environmental settings and methodologies (Hordonic, 2018). For example, using survey, Aladede, (2011) in Nigeria, Dyeganto, (2018) in Ethiopia, Ahamad, (2018) in Malaysia, and Fjeldstaldet *et al.*, (2020) in Tanzania concluded that perceived severity of penalties has positive and significant effects on the decision of the taxpayers to pay taxes within due dates. Experimental studies performed by Hoopes *et al.*, (2021) and Dewi *et al.*, (2022) conclude that perceived severity of penalties affects compliance behaviour of taxpayers.

Moreover, other empirical studies evidenced that level of severity of penalties has no impact on tax compliance behaviour (Engida and Baisa, 2014), or may have short-run impact on compliance while creating long-run future non-compliance (Carrillo *et al.*, 2017; Slemord, 2019) or the impact is much felt on the higher than lower income earners (Slemrod, 2018).

Conclusively, despite a bounty of empirical evidence, the impact of severity of penalties on decision of taxpayer to pay taxes within due dates is somewhat inconsistent and mixed (Alam, 2020; Dewi *et al.*, 2022). Hence, this study developed the following hypothesis;

H3: Perceived severity of penalties has positive and significant effect on taxpayers' decision to pay taxes within the due dates

2.5 Main Research Gaps

This study has filled the apparent knowledge and empirical gaps in prior researches concerning the effects of perceived severity of penalties on tax compliance. Besides providing mixed and inconclusive findings (Dewi *et al.*, 2022; Wijaya, 2023), these studies were done in different environmental settings and methodology (Hordonic, 2018). Hence, findings of this study on the perceived effects of severity of penalties on tax compliance behavior filled this gap as it addresses specifically SMEs in Tanzania. The study collects data using survey method which provides more realistic nature of the phenomenon than experiments which were used in most of the previous studies. Moreover,

these findings can be generalized to other SMEs in developing countries as they have similar characteristics and challenges to tax compliance as Tanzanian SMEs (Ropikiet *al.*, 2023). Lastly, this study articulates clearly that perceived severity of penalties is much felt at the registration and declaration stages in the compliance cycle, but not on the payment stage.

3.0 METHODOLOGY

The study context was based on the SMEs in Tanzania. They comprise a significant portion of the workforce ILFS, 2021), contribute more than 60% of the Gross Domestic Product (Muiithi, 2017), hence potential for revenue generation (Mkendaet *al.*, 2023).

The study was carried out in the six selected tax regions in Tanzania, which were Kinondoni, Kariakoo, Temeke, Mtwara, Singida and Tabora. These regions were selected based on the findings of the Afro-barometer survey 2011-12 round, where regions of Kinondoni, Kariakoo, and Temeke showed 54% of the respondents have positive tax attitudes, Singida and Tabora, 34% and Mtwara, 22% which was the lowest rating in Tanzania. The national average was 47% (Ali *et al.*, 2014). The study anticipates perceptions on the severity of the sanctions influences compliance attitudes and actual behavior of the taxpayers, therefore, variations in the compliance attitudes may be caused by the differences in the perceptions on the severity of the penalties. Moreover, the regions were selected based on the intensity of business and revenue performance in the respective regions (URT, 2022).

The unit of analysis was the SMEs, and enquiries were made to the owners, managers, or supervisors in the business whom the researchers believe have adequate knowledge or understanding of the tax matters and information relating to daily business operations (Kamleitneret *al.*, 2012). Managers and supervisors are entrusted by the owners to operate the business in their absence; hence they have required knowledge in tax matters and affection to the business (Mkendaet *al.*, 2023).

The study adopted an explanatory cross-sectional research design. It was considered appropriate due to financial constraints and time limitations, whereby data was gathered at once (Kamleitneret *al.*, 2012). Cross-sectional survey studies have been useful in collecting data on the perceptions and attitudes of the respondents (Tusubira, 2018). Although data is collected once, these perceptions refer to the past experience and evaluation of the particular object, person, phenomenon, or behavior (Azjen, 1991). According to Azjen, 1991, perceptions of an individual may be relatively stable over a period of time

and incorporated changes resulting from the social-economic environment, hence presenting suitable data in analyzing tax compliance behavior (Onu, 2016).

In this study, the sample size of 420 respondents was obtained from the total population of 2,700,000 registered individual taxpayers in the country (URT, 2022). The sample was calculated using Taro Yamane formula at 95% confidence interval and margin of error of 5% (Yamane, 1967). The formula is suitable for calculating sample size in the survey studies with finite population (Uakarnet *al.*, 2021). Simple random sampling was employed to minimize bias in the selection of the respondents (Creswell, 2014). In each tax region, 70 respondents were selected to participate in the study, so as to have equal representation of each tax region in the sample (Msangi, 2015).

Primary data were collected through use of the self-administered structured questionnaire. Questionnaire was used to collect data from the respondents because it is a superior instrument in gathering information swiftly, timely and it is cost efficient for a large number of participants and precisely analyze behaviors, attitudes, perceptions, and intentions (Saunders *et al.*, 2019). To ensure credible findings and conclusions thereon, various diagnostic tests were performed on the data collected. These relate to common method bias, non-response bias, validity and reliability (Hair *et al.*, 2021).

The independent variable in this study is perceived severity of the penalties. The variable was measured using five questions using five points Likert-scale with strongly disagree, value = 1 and strongly agree, value = 5 on the five indicators which are *penalties imposed for non-compliance are too high; penalties imposed for non-compliance may erode my savings from tax evasion; penalties affect negatively the financial situation of my enterprises; penalties may make me regret for not complying with tax laws; and penalties will make me to become more compliant* (Msangi, 2015).

Dependent variable in the study is income tax compliance behavior. An individual complies with the income tax law under the three stages of registration into the tax system, correct declaration of income and payment of taxes within due dates (OECD, 2004). The researcher examined how the decision to act in the phase of compliance was reached, whether voluntarily, convinced or enforced [enforced = 1; convinced =2; voluntary =3] (Deyganto, 2018).

We performed Variance Inflation Factor [VIF] to test presence of biasness or collinearity in the data (Kock, 2015), Paired Sample Test for Non-Response

Bias [NRB] (Groves, 2016), Cronbach Alpha to test for reliability, Average Variance Extracted [AVE] and Heterotrait – Monotrait Ratio [HTMR] to test for validity (Hair et al., 2021). Questionnaire response rate and respondent profiles were analyzed descriptively, while path coefficients explained the influence of perceived severity of penalties on dependent variables (Hair et al., 2021).

4.0 FINDINGS AND DISCUSSION

4.1 Diagnostic Tests

Common Bias and Non-Response Bias Tests

Common Method Bias occurs when data for measuring independent and dependent variables are collected from the same subject in the same measurement context using the same object (Kanshaba et al., 2023). This study tests the presence of the CMB using full collinearity measures, where Variance Inflation Factor was employed (Kock, 2015). The acceptable value of VIF is below 3.3 (Kock, 2015), although maximum tolerance of 5 can be accepted, considering provision of errors in the statistical analysis packages (Kock, 2015). The results of the tests are within the acceptable range, hence assured there is no common bias in the data [refer to Table 4.1, below].

Table 4.1: Multicollinearity checks (Variance Inflation Factor (VIF) <3

Independent Variables	DECL (VIF)	REG (VIF)	PAY (VIF)
Penalty Severity [SS]	2.04	2.04	2.04

Furthermore, we tested existence of non-response bias using Paired Sample Test. Non-response bias exists when individuals who were targeted to participate in the survey systematically differ from those who respond to the questionnaire (Kansheba, 2023). Test results as per Table 4.2, showed there is no significant difference between mean and standard deviation of the two pairs of participants; hence there is no risk of non-response bias (Groves, 2006).

Table 4.2: Non-Response Bias Test [Paired Sample Test]

Variable		Paired Differences					t	df	Sig. (2-tailed) p-value
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Gender	-.41579	1.06073	.17207	-.76444	-.06714	-	37	.021
							2.416		
Pair 2	Age	-.47368	.96058	.15583	-.78942	-.15795	-	37	.004
							3.040		

Pair 3	Education	-.44737	1.87167	.30363	-1.06257	.16784	-	37	.149
							1.473		
Pair 4	Capital size	-.64912	1.04536	.16958	-.99272	-.30552	-	37	.006
							3.828		

4.2 Results of Descriptive Statistics

Questionnaire Response Rate Analysis

The total number the questionnaire was distributed to was 420. Out of these, 382 questionnaires were returned, representing a response rate of 91% [refer to Table 4.3].

Table 4.3 Summary of Distributed Questionnaires and Response Rate

Serial No.	Tax Region	Distributed Questionnaires	Respondents	Response Rate
1.	Kariakoo	70	64	91.4%
2.	Temeke	70	61	87.1%
3.	Kinondoni	70	70	100.0%
4.	Mtwara	70	54	77.1%
5.	Singida	70	63	90.0%
6.	Tabora	70	70	100.0%
		420	382	91.0%

Source: Survey Data and Own Computation.

SMEs and Respondents' Profiles

Respondents were predominantly male [N=199, 52.1%], and most were aged between 18-35 [N= 272, 71.2%]. Most of the respondents were single [N = 208, 54.5%] and in terms of education level majority of them attained primary school education [N = 172, 45%], [refer to Table 4.4].

Furthermore, as indicated in Table 4.6, out of 382 SMEs contacted, 18.3% were from Kinondoni, 16.8% from Kariakoo, 16.0% from Temeke, 18.3% from Tabora, 16.5% from Singida and 14.1% from Mtwara. This study found that, 45% of the SMEs' management had primary education level, secondary education was 34.8%, while university education was 17.0%, and vocational training 3.1%. Their level of education implies that they have the ability to comprehend on tax matters (Msangi, 2015), thus level of education has an impact on compliance behaviour (Appiah et al., 2024). Moreover, majority of the SMEs [89.1%], contacted had more than 10 employees which signifies their potential in providing employment opportunities (Muiithi, 2017). On the other, most of the SMEs contacted had capital below Tzs. 200m.

Table 4.4: Respondents' Characteristics

SN	Category of the respondents' characteristics	Number of respondents	Frequencies of respondents	Percentage of the respondents
1	Gender			
	Male	382	199	52.1%
	Female		183	47.9%
2	Age			
	18-35	382	272	71.2%
	36-60		108	28.3%
	61-70		2	0.5%
3	Marital Status			
	Single		208	54.5%
	Married	382	174	45.5%
4	Level of Education			
	Primary Education		172	45.0%
	Secondary Education	382	133	34.8%
	Vocation Training		12	3.1%
	University Education		65	17.0%
5	Number of Employees			
	Less than 10		41	10.7%
	10 – 20	382	323	84.6%
	20 – above		18	4.7%

Table 4.5: SMEs Profiles

SN	Profile Details	Number of SMEs	Percentage (%)
1	Location		
	Kariakoo	64	16.8%
	Kinondoni	70	18.3%
	Temeke	61	16.0%
	Tabora	70	18.3%
	Singida	63	16.5%
	Mtwara	54	14.1%
2	Management Characteristics		
	Male	208	54.5%
	Female	174	45.5%
	Primary Education	172	45.0%
	Secondary Education	133	34.8%
	Vocation Training	12	3.1%
	University Education	65	17.0%
3	Number of Employees		
	Less than 10	41	10.7%
	10 – 20	323	84.6%
	20 – above	18	4.7%
4.	Size of Capital		
	5,000,000 – 100,000,000	123	32.2%
	100,000,000 – 250,000,000	242	63.4%
	250,000,000 - 800,000,000	17	4.4%

Assessment of the Reflective Measurement Model

This study utilized Structural Equation Modelling [SEM-PLS] because of its ability to model latent constructs and establishes direction and strength of relationship between variables through bootstrapping procedures (Saad, 2011). The suitability of this model was tested using indicator reliability, internal consistency reliability, convergent validity, and discriminant validity (Hair *et al.*, 2021).

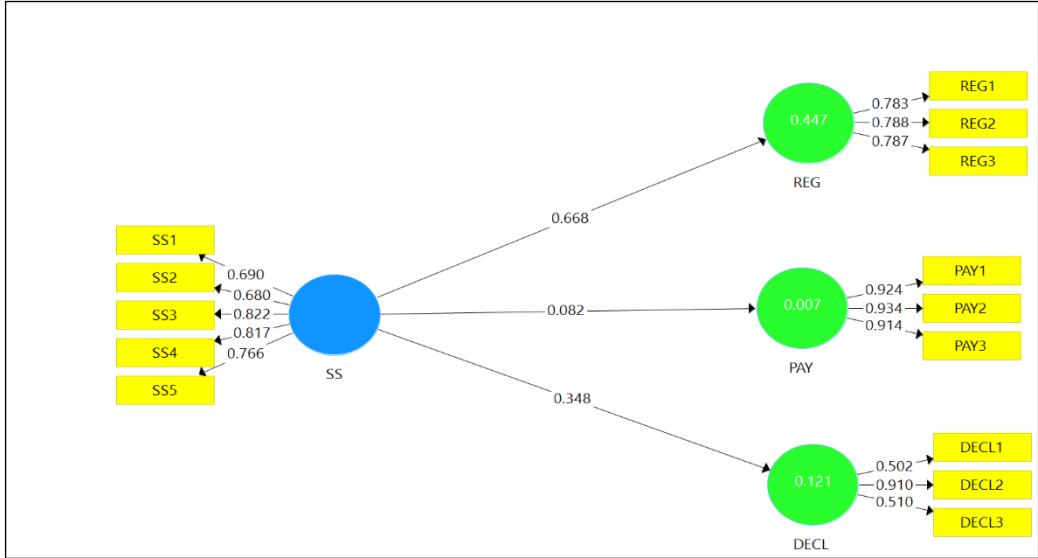
Indicator reliability refers to the ability of the construct to account for more than 50% of the indicator variance in the measurement of the variable (Hair *et al.*, 2021). The acceptable value should be greater than 0.7; however, values between 0.4 to 0.7 can also be acceptable (Hair *et al.*, 2021). All tested values fall within the acceptable range; hence indicator reliability was assured [See Table 4.6 and Figure1].

Internal consistency reliability refers to the suitability of the indicators to measure the construct consistently (Hair *et al.*, 2021). Composite reliability and Cronbach Alpha test results showed values greater than 0.7, hence internal consistency reliability was assured (Hair *et al.*, 2021).

Convergent validity refers to the extent to which indicator is able to measure a construct precisely. It is verified by using Average Variance Extracted [AVE] and acceptable value should be greater than 0.5 (Hair *et al.*, 2021). Tested values falls within the acceptable range hence convergent validity assured (See Table 4.6).

Discriminant validity refers to the extent to which each study variable is distinct from other study variables (Duarte and Raposo, 2010). It is measured precisely using the Heterotrait – Monotrait Ratio [HTMR] (Henseler *et al.*, 2015). All tested values in this study are below 0.85 hence discriminant validity assured [See Table 4.6).

Figure 4.1: Reflective Measurement Model



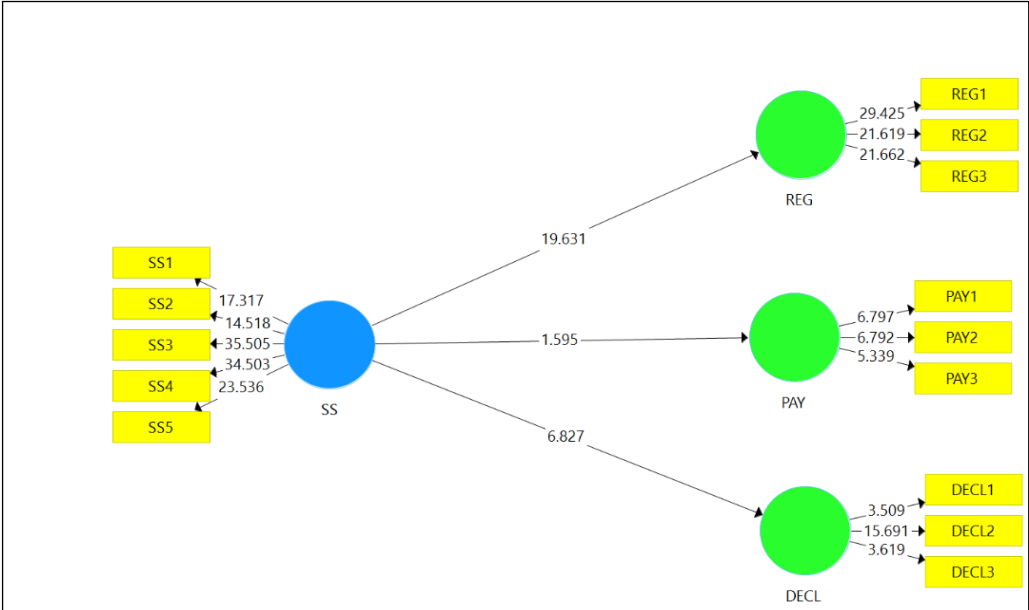
The model ‘s goodness-of-fit was examined using Root Mean Square Covariance. The acceptable value of RMS, theta should be less than 0.14 (Hair *et al.*, 2021). The test theta value in this study was 0.127 which is below 0.14, hence the model is fit in predicting the results.

Table 4.6: Results of Assessment of the Reflective Measurement Model

S/N	Indicator	Indicator reliability	Composite reliability	Cronbach Alpha	Convergent Validity [AVE]	Discriminant Validity [HTMR]
1	SS1	0.689	0.868	0.813	0.569	0.139
2	SS2	0.680				
3	SS3	0.823				
4	SS4	0.816				
5	SS5	0.717				
6	REG1	0.759	0.881	0.821	0.651	0.180
7	REG2	0.808				
8	REG3	0.798				
9	DEC1	0.654				
10	DEC2	0.788				
11	DEC3	0.680				
12	PAY1	0.934				
13	PAY2	0.933				
14	PAY3	0.901				

SS1,2,3,4,5= Perceived Severity of Penalties REG 1,2,3, = Registration into the Tax System.
DEC1,2,3 = Correct Declaration of Income. PAY 1,2,3 = Payment of Taxes within Due Dates.

Results of Structural Model



Path Coefficients

The path coefficient showing relationship between independent variable [perceived severity of penalties] and dependent variables, that is registration, declaration, and payment of taxes within due dates is shown in Table 4.7 below.

Table 4.7: Results of Hypotheses Testing [Direct Relationship]

Path	Beta (B)	T Statistics	P Values	95% Confidence Interval	REMARKS
SS -> DECL	0.074	6.827	0.000	[-0.155; 0.093]	Supported
SS -> REG	0.052	18.463	0.000	[0.115; 0.288]	Supported
SS -> PAY	0.079	1.595	0.126	[-0.085; 0.177]	Not Supported

SS= Perceived Severity of Penalties REG= Registration into Tax System
DECL = Correct Declaration of Income PAY= Payment of Taxes within Due Dates

Influence of Perceived Severity of Penalties on Registration into the Tax System

The findings [see Table 4.7] showed that perceived severity of penalties has positive and significant influence on the decision of taxpayers to register in the tax system [Beta value = 0.052; T-statistics = 18.463; p-values = 0.000; Confidence Interval 0.115; 0.288]. Therefore, Hypothesis 1 is supported.

The findings imply that decisions of the individuals to register their business in the tax system are significantly influenced by their perceptions on the severity

of penalties imposed in case of non-compliance. There are higher chances for the individual who perceived penalties imposed for non-compliance with the registration requirements to be severe to comply than those who perceive penalties as lenient.

The findings support the predictions of the economic and prospect theories (A-S, 1972) which asserts that when sanctions for non-compliance are severe, taxpayers will opt to comply with tax laws. Similarly, these results are consistent with findings from previous studies which concluded that perceived severity of penalties has a positive and significant impact on tax compliance (Msangi, 2015; Slemrod, 2019).

Influence of Perceived Severity of Penalties on Correct Declaration of Income

Furthermore, findings [see Table 4.7] show that perceived severity of penalties has a positive and significant influence on decision of the taxpayer to declare correctly their income to the tax authority [Beta = 0.074; T-statistics = 6.827; p values = 0.000; C.I (-0.155; 0.093)]. Therefore, Hypothesis 2 is supported.

The findings imply that decision of the taxpayers to declare their income correctly to tax authority is significantly influenced by their perceptions on the severity of penalties imposed in case of non-compliance. Taxpayers who perceive penalties to be severe are more likely to declare their income correctly to the tax authority, than those who don't perceive so.

The findings supported predictions of economic deterrence and prospect theories, that taxpayers declare their income correctly when they perceive penalties imposed for non-compliance are severe, hence will negatively affect their financial position (Alam, 2020). Moreover, they are similar to some of the findings of the previous studies (Del-Carpio, 2014; Msangi, 2015; Kleven *et al.*, 2016; Deyganto, 2018; Rahman *et al.*, 2024).

Influence of Perceived Severity of Penalties on Payment of Taxes within Due Dates

Lastly, findings [see Table 4.7] show that perceived severity of penalties has a positive but insignificant influence on the decision of taxpayers to pay taxes within due dates [Beta = 0.079; T-statistics = 1.595; p-values = 0.126; C.I (-0.085; 0.177)]. Therefore, Hypothesis 3 is not supported.

The findings imply that perceived severity of penalties is not a strong factor in the decision of the taxpayers to pay taxes within due dates. The findings don't fully support the predictions of the economic deterrence theory, which asserts

that an increase in the level of severity of penalties enhances tax compliance behavior (Allingham and Sandmo, 1972). Moreover, the findings are similar to previous studies (Carrillo *et al.*, 2017; Slemrod, 2019; Heriel&Vishail, 2020).

The ability to pay (Alabedeet *al.*, 2011), financial conditions of SMEs ((Olomi &Mori, 2015; Mkendaet *al.*, 2023), strong feeling that money for payment of taxes is a business asset that should not be released to the government (Msangi, 2015) and poor subjective norms of tax compliance (Francis &Bishagazi, 2021), may moderate influence of perceived severity of penalties on compliance behaviour of taxpayers.

5.0 CONCLUSIONS AND RECOMMENDATIONS

Theoretical Contributions: Findings of this study provide more evidence on the emerging compliance literature on the use of prospect to complement economic theory in explaining compliance behaviour of an individual (Hordonic, 2018). The theories predict perceived severity of penalties influences taxpayers to comply with tax laws. Our study tested these predictions on the three stages in the compliance cycle, that is registration in the tax system, correct declaration of income and payment of taxes within due dates. Findings showed that perceived severity of penalties is much felt in the registration and declaration than at payment stages of the compliance cycle. therefore, providing a novel insight into the application of these theories in explaining the behaviour of taxpayers (Msangi, 2015; Deyganto, 2018). Our study emphasized on applying a combination of theories in explaining the cycle of behaviour of taxpayers.

Practical and Policy Contributions: Findings of this study suggest that government should formulate compliance strategies that change the behaviour of the taxpayers at all stages in the compliance cycle. The existing penalties to address non-compliance behaviour at the registration and declaration stages are perceived to have more deterrent effect on compliance than at the payment stages. Therefore, this study recommends other administrative measures to enhance compliance in paying taxes on the due dates, for example using various forms of communication to remind the taxpayers on the consequences of non-payment of taxes, fairly and consistent application of penalties to punish those who don't comply, and providing taxpayer education.

Limitations and Future Research

Although this study has several intriguing findings and contributions, it has several shortcomings that could be noted for future research. The present study collected data through cross-sectional method, hence more longitudinal study is

required to analyse patterns of perceptions over specified time. Moreover, this study used quantitative method only and covers six selected tax regions in Tanzania, which provides opportunity for future research using mixed approach in other tax regions to enhance comprehension of the phenomenon. Finally, this study considers the impact of only one predictor on the compliance behaviour of taxpayers. Future studies may consider impact of other predictor variables on the compliance behaviour.

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ACKNOWLEDGEMENT

We would like to thank the management of the Mzumbe University for providing the permission to proceed to carry out the research work. Moreover, the management of the Tanzania Revenue Authority for providing permission to carry out the study in the respective tax regions.