The Effects of Social Influence Factors on Income Tax Evasion among the Palestinian SMEs

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Abstract

The phenomenon of tax evasion has proved to be a common challenge across both the developing and developed countries. This may be considered a vital threat to national revenue of any government, and results in fiscal deficits. In the case of the developing countries, Palestine depends heavily on the revenue from tax and funds coming from international aids in financing the national growth plan. Hence, this study aims at examining the interrelationships among tax fairness, peer influence, corruption, and income tax evasion based on the theory of Social Influence. The procedure involved a proportionate sampling of the targeted respondents, and the data collection was achieved quantitatively by means of appropriate questionnaires. The returned questionnaires were screened and only 184 were useful for analysis. The analysis of the data was done by means of Partial Least Square (PLS) software. The outcome of the data analyses revealed that both peer influence and tax fairness had a negative but significant influence. Regarding corruption, it was insignificant though was positive in relation to the evasion of the income tax. This finding implies that the income tax administration efficiency can make a maximum gain from tax collections as well as discourages tax evasion.

Keywords: Tax evasion, tax fairness, peer influence, corruption.

1. Introduction

Essentially, each government relies on generating revenues via sources that can be tax and non-tax in order to execute projects and offer services to their citizens (Alm & Torgler, 2011). In other words, tax revenue represents the earliest and most sustainable means of accruing revenue by the governments worldwide for supporting their expenses. Consequently, a greater part of the economy of most countries is based on taxation (Abuamria, 2019; Edwin, 2011). In this regard, the degree to which any government is able to generate revenues depends on a lot of factors (Torgler, 2005; Alshrouf, 2019). However, the willingness of a taxpayer to adhere to the tax laws remain a major factor in attaining a high level of tax collection by voluntary compliance. According to Kirchler (2007), the inability of taxpayers to abide by the important provisions of tax law signifies the existence of tax evasion. Consequently, tax evasion remains a main challenge confronting the tax authorities all over the world and its practice continues to rise and become more difficult to be tackled due to creative ways and dynamism of tax evasion schemes (Alleyne & Harris, 2017). As such, Franzoni (2000) refers to tax evasion as the most rampant and decisive challenge confronting tax administrations. Therefore, tax evasion could be considered an intentional dishonest act of reducing tax responsibility by the taxpayers (Alm, Martinez-Vazquez, & McClellan, 2016).

Being a developing country, Palestine depends to a large extent on tax revenue and aids from international bodies as source of fund for national growth along with development (Alkhatib & Abdul-Jabbar, 2017). Hence, Palestine's income tax administration is characterised by having serious

challenges related to tax evasion (Alkhatib, Abdul-jabbar, & Marimuthu, 2018; Rahhal, 2017). More recently, the "Coalition for Integrity and Accountability in Palestine" projected that 500 million USD is lost annually from the Palestinian treasury as a result of tax evasion (Coalition for Accountability and Integrity, 2018) or between USD 500 and USD 600 million as reported by Jaber (2018). Regarding the income tax evasion, the Finance Minister stressed that 80% of people accounted for just 10% of the income tax (Bishara, 2015).

Although in Palestine SMEs constitute 99% of business taxpayers, as they contribute only 30% of the total revenues from income tax. The results is a reduction of the expected size of revenue from these SMEs (Fallah, 2014) and implies that several SMEs are highly engaged in tax evasion (Sabri, 2010). Due to the present rate of tax evasion activities in Palestine, a necessity arises to present a detailed evaluation of the crucial economic factors influencing tax evasion in order to formulate the required policies for raising the revenues of the government.

2. Literature Review and Hypothesis Development
2.1. Tax Fairness and Tax Evasion
Tax fairness is considered a non-economic variable that determines tax evasion and an important factor in taxpayers' decision-making (Farrar, Kaplan, & Thorne, 2017). Some taxpayers take part in tax evasion act, whereas at the same time, the sincere taxpayers continue to meet their taxes obligation because of their strong perception towards the need to fulfil tax obligations. When the government enforces taxes increment, the new tax may increase the burden on taxpayers, thereby encouraging them to engage in tax evasion (AlAdham, Abukhadijeh, & Qasem, 2016). In this context, Farrar et al. (2017) infer that the intention to comply with tax is higher when the interactional fairness is high. Accordingly, Richardson (2006) assessed the correlation between tax fairness and tax evasion and found an inverse relationship implying that greater levels of tax fairness leads to a lesser tax evasion rate. In addition, scholars added that when the tax system is considered unfair, taxpayers tend to be less compliant (Wenzel, 2002) or transactions with the tax authorities are unfair (Wenzel, 2006). In contrast, some studies reported an insignificant influence of tax fairness on tax evasion. Notably, Porcano (1984) reported the relationship existing between the vertical tax fairness as well as tax evasion is insignificant. Likewise, other studies such as Faizal and Palil (2015) and Saad (2009) in the Malaysian context reported similar findings.

Accordingly, studies point out that there exist negative relationship between the perception towards tax fairness as well as tax evasion. That is, when tax fairness is perceived as high, it result in a higher compliance attitude (Akdede 2006; AlAdham et al. 2016; Chan Troutman and O'Bryan, 2000; Fischer et al. 1992; McGee and Maranjyan 2006). However, few other studies have found an insignificant effect of tax fairness on tax evasion (Porcano 1984; Faizal and Palil 2015; Saad 2009). Considering the above discussion related to tax fairness-tax evasion relationship, the current study proposes the following hypothesis:

H1: There is a negative relationship between Tax Fairness and Tax Evasion.

2.2. Peer Influence and Tax Evasion
Peer groups are highly influential in shaping the individuals' preferences, values as well as their behaviours (Al Zeer, Alkhatib, & Alshrouf, 2019). The notion of 'peer' is commonly defined as associates of taxpayers including their friends, relatives, colleagues, and co-workers (Jackson & Milliron, 1986). The influence of peer groups on tax taxpayers is high, thus affecting the taxpayers' preferences, personal values, and behaviours (Puspitasari & Meiranto, 2014). In taxation perspective, the attitude of other taxpayers influences the compliance behaviour of other taxpayers (Alm *et al*. 2016). Hence, the propensity of any taxpayer to file tax return will be high if he/she has the perception that other taxpayers are also complying with their tax duties. Therefore, the choice of decision by a taxpayer

could be influenced by his/her peers, friends as well as co-workers, individuals or groups like the family (Beck & Ajzen, 1991). When the taxpayers perceives the existence of high tax evasion among some particular referent groups, their likelihood of compliance will be very low (Kirchler *et al*., 2008). Accordingly, the belief of taxpayer's towards other taxpayers' compliance attitude determines his/her compliance decision. In other words, taxpayers are less inclined to be dishonest regarding their taxes payment if peers act honestly (Frey & Torgler, 2007; Traxler, 2010). Thus, having a better opinion related to the compliance rate of other associates of the society could decrease the degree of tax evasion (Çevik and Yeniçeri, 2013) and vice-versa.

In summary, previous studies have established a significantly negative effect of peer influence on tax evasion (Alleyne & Harris, 2017; J Alm et al., 2016; Beck & Ajzen, 1991; Çevik & Yeniçeri, 2013; Fischbacher, Gächter, & Fehr, 2001; Kirchler et al., 2008), whereas only few extant studies have revealed an insignificant effect (Hanno & Violette, 1996; Hite, 1988; Palil, Zain, & Faizal, 2012). Consequently, the following hypothesis is derived:

H2: There is a negative relationship between peer influence and tax evasion.

2.3. Corruption and Tax Evasion

Corruption results from payment of a particular sum of money by an individual as an exchange for an illegal activities involving public officer (Andreoni et al., 1998). Based on the perspectives of McClellan (2013), corruption practices tend to greatly reduce the revenue capacity of the government since any taxpayer could easily evade tax relying on bribes paid to the government tax officials instead of paying full taxes. The challenges of corruption are widely spread, whereas the sources of corruption are yet poorly comprehended by the policy makers (Carvalho et al., 2016). It seems that corruption is regarded as a growing threat in the majority of the developing countries (Alabede, 2012) since some public officials are mostly self-centred to abuse public trust to achieve personal benefits (Alm et al., 2016). Consequently, corruption has been established to show significant determinant of tax conformity behavior (Alm et al., 2016; Torgler, 2003) which discourages taxpayers from the payment of their taxes (Uslaner, 2010), thus limiting the taxpayers' compliance behaviour (Torgler, 2003). In this regard, Bilotkach (2006) showed that corruption among the employees of tax authority in Ukraine has a considerable effect on tax evasion. Nevertheless, few other empirical studies revealed opposing findings. For instance, Akdede (2006) focused on bribery among the government officials and found that bribery has a negative relationship with tax evasion. This shows that taxpayers could willingly decide paying taxes rather than engaging in corruption when the cost of bribery is huge. Also, Imam and Jacobs (2014) established that the relationship between corruption and total tax revenue is insignificant.

In addition, several extant empirical findings revealed a positive influence of corruption on tax evasion (Alm *et al*., 2016; Bilotkach, 2006; McGee & Maranjyan, 2006; Picur & Riahi-Belkaoui, 2006; Uslaner, 2010), whereas a few studies have indicated that the relationship between them are either negative (Akdede, 2006) or insignificant (Imam & Jacobs, 2014). Therefore, in an effort towards improving the knowledge on relationship between corruption and tax evasion, this study proposes hypothesis as follows:

H3: There is a positive relationship between corruption and tax evasion.

3. Research Framework

The model for the current study is shown in Figure 1 below. The model is developed based on the Social Influence Theory, proposing that the perceived tax fairness, peer influence, and corruption affect the tax evasion behavior. The Social Influence Theory focuses on the individual's emotions, opinions or behaviours as affected by other individuals (Sussman & Gifford, 2013). The theory of Social Influence is linked to the Social Learning Theory, founded by Bandura's (1977) initiative that an

individual is influenced by the surrounding environment. Crisp and Turner (2007) explained that the social influence is associated with the way individual's thoughts, feelings and behaviour are altered due to the influence of other individuals.
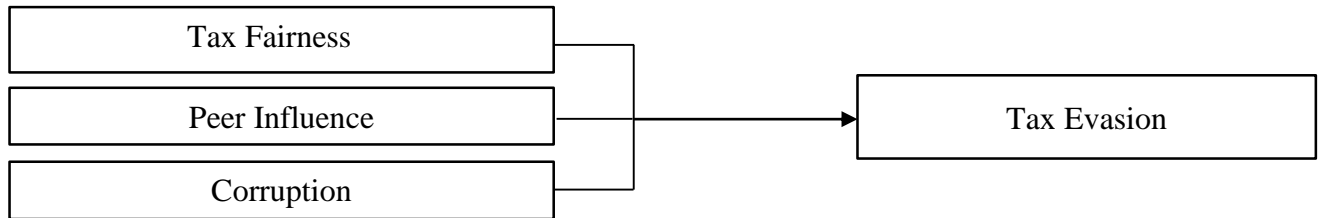
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┌─────────────────────────────┐
│         Tax Fairness        │──┐
├─────────────────────────────┤  │      ┌──────────────────────┐
│        Peer Influence       │──┼─────→│     Tax Evasion      │
├─────────────────────────────┤  │      └──────────────────────┘
│          Corruption         │──┘
└─────────────────────────────┘
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Figure 1: Research Model

4. Methodology

The current study employed data gathered at level of business entity depicting the unit of analysis of the study. Data was retrieved from total of 500 SMEs registered with "the Federation of Palestinian Chambers of Commerce, Industry, and Agriculture". The distribution of questionnaires was implemented using a proportionate random sampling method among the selected respondents, namely SMEs owners or managers. Questionnaire dissemination covers a period of two months with about 184 analysable data retrieved post screening of the questionnaires, this represented 37% response rate.

The variables as well as items deployed in the research study were all adapted through extant studies. Responses to items were based on five-point Likert-scale with options covering strongly disagree as 1 down to strongly agree as 5, all through variables in the study. Total of 15 items that measured tax evasion were all adapted from Giligan and Richardson (2005). Also, for the aims of increasing the internal validity a reverse coding approach was applied in item 5 for this study (Efebera et al., 2004), but this was not the case in the original study by Gilligan and Richardson (2005). Tax fairness was measured by 7 items which were adapted from Gilligan and Richardson (2005)", whereby the items 1, 2 and 3 were used in reverse coding, and the current study also adopted the same items in measuring tax fairness. Peer influence with 6 items were adapted from Braithwaite (2001), whereby a reverse coding technique was applied for the case of item 5 of this study. In addition, corruption was measured using 6 items which was adapted from Martin *et al*. (2007).

5. PLS Data Analysis and Results

In evaluating the model of this research, the study employs the Partial Least Squares (PLS) analysis technique through Smart PLS 3. The analysis of the measurement model (constituting the relationship amongst variable alongside their indicators) were done by employing two stage analytical technique recommended by Anderson and Gerbing (1988). Similar method was as well applied to test the structural model (which is the relationships between the variables) in this study (Hair et al. 2017).

5.1. Assessment of Measurement Model

Assessing measurement models involved two (2) measurements of validity including convergent alongside discriminant validity. While convergent validity is measured through the loadings of indicators, average variance extracted (AVE), and composite reliability. The results are presented in Table 1; "the loading for all the items was found to exceed minimum threshold of 0.50. The values ranged from 0.608 to 0.888, the AVE values ranged from 0.500 to 0.706, and they were as well above recommended threshold of 0.50, whereas the composite reliability values also varied from 0.836 to 0.935, and these also exceeds recommended threshold of 0.70 (Hair et al., 2017). However, the items

number 7, 10, and 15 for tax evasion, and items number 7, 6, and 6 for tax fairness, peer influence, and corruption, respectively were deleted due to the low indicator loadings. Finally, considering the outcomes, the present study is argued to have a reliable convergent validity.

Table 1. Convergent validity

Variables	Items	Loading	CR	AVE
Tax Evasion	TE1	0.740	0.923	0.500
	TE2	0.729		
	TE3	0.740		
	TE4	0.746		
	TE5	0.734		
	TE6	0.680		
	TE8	0.696		
	TE9	0.671		
	TE11	0.673		
	TE12	0.709		
	TE13	0.698		
	TE14	0.658		
Tax Fairness	TF1	0.835	0.935	0.706
	TF2	0.888		
	TF3	0.781		
	TF4	0.859		
	TF5	0.844		
	TF6	0.832		
Peer Influence	PI1	0.741	0.895	0.632
	PI2	0.835		
	PI3	0.773		
	PI4	0.868		
	PI5	0.750		
Corruption	CO1	0.681	0.836	0.508
	CO2	0.680		
	CO3	0.608		
	CO4	0.829		
	CO5	0.748		

After establishing the convergent validity, another test that was followed is the discriminant validity based on the criterion by Hair et al. (2017). The measurement involves comparison between square root of AVE along with correlations values of latent variables. The result is presented in Table 2, whereby the square roots of AVE's were all greater for all the cases as compared to diagonal values from each rows and columns. Therefore, the adequacy of the discriminant validity is confirmed. Generally, the result obtained from validity tests of the measurement model in the current study indicates a satisfactory outcome for convergent as well as discriminant validity.

Table 2. Discriminant Validity Analysis

Variables	TE	TF	PI	CO
Tax Evasion (TE)	**0.707**			
Tax Fairness (TF)	-0.283	**0.840**		
Peer Influence (PI)	-0.314	0.369	**0.795**	
Corruption (CO)	0.104	-0.107	-0.053	**0.713**

5.2. Assessment of Structural Model

Strength of prediction for the current research model represented by R-square (R^2) or the coefficient of determination gives an account of the shared contribution of the exogenous and endogenous factors in the study (Hair et al., 2017). By using the Smart PLS algorithm function, the R^2 value was measured to show the quantity of variation which the exogenous variables accounts for (Hair et al., 2017). Hence, these three variables have R^2 value of 0.136 which indicates that 13.6% of the variation in the income tax evasion is jointly explained by tax fairness, peer influence, and corruption.

Next, a bootstrapping was carried out by applying 5,000 re-sampling from 184 cases in order to assess the significance of the path coefficients (β) applying the one-tailed test. Thus, the results of the path estimates as well as the t-values were as well measured with respect to the hypothesized relationships of this present study. The outcome of the analysis of the structural model is presented in Table 3. Based on the parameters of tax fairness (β = -0.186; t = 3.059; p = 0.001) along with those of peer influence (β = -0.242; t = 3.205; p = 0.001), the result indicates a negative association with tax evasion, thus affirming hypotheses H_1 and H_2. Accordingly, the result showed an insignificant influence of corruption on tax evasion. Hence, H_3 is not supported (β = 0.072; t = 0.626; p = 0.266).

Table 3. Results of Hypotheses Testing

Hypothesis: Path	Path Coefficient	T-Statistics	P-Value	Decision
H_1: Tax Fairness -> Tax Evasion	-0.186	3.059	0.001**	Supported
H_2: Peer Influence -> Tax Evasion	-0.242	3.205	0.001**	Supported
H_3: Corruption -> Tax Evasion	0.072	0.626	0.266	Not Supported

Note: Significant at **p < 0.01, *p < 0.05.

5.3. Predictive Relevance

Aside from the R^2 value, the predictive relevance (Q^2) is considered another valuable statistic which employs resampling technique (Henseleret al., 2009). In order to assess the predictive relevance of the endogenous variable, the blindfolding technique was employed with multiple or single item in the reflective measurement model (Hair *et al*., 2017). In accordance with Hair *et al*. (2017) and Henseler *et al*. (2009): "a cross-validated redundancy measure Q^2 value which is greater than zero implies the predictive relevance of the model". As a result, the result for this test disclosed that the model of this present study exhibits predictive relevance for endogenous factors as presented in Table 4.

Table 4. Variable Cross-Validated Redundancy (Q^2)

Endogenous latent variable	SSO	SSE	1-SSE/SSO
Tax Evasion	2,208.000	2,090.794	0.053

6. Discussion

The targeted objective of the study was the assessment of the influence of tax fairness, peer influence, and corruption on income tax evasion among the SMEs owners-managers. The manner in which taxpayers conceive a tax system to be fair is a vital determinant of tax evasion choice (Kostritsa & Sittler, 2017). The current study has established that the relationship of tax fairness and income tax evasion is significantly negative. Accordingly, the outcome of the present study are in line with the most existing empirical literature that also confirmed a significant and negative influence of tax fairness on tax evasion (Alm, Jackson, & McKee, 1992; Belay & Viswanadham, 2016; Cummings, Martinez-Vazquez, McKee, & Torgler, 2009; Farrar *et al.*, 2017). This outcome could be because the SMEs' owners-managers perceive fairness in the tax system. As a result, they were motivated to comply with tax payment. Thus, fairness in the tax system promotes compliance, and this is in harmony with the Theory of Social Influence. Consequently, encouraging tax fairness and equity in the Palestinian tax system will achieve the target of reducing tax evasion among the Palestinian SMEs.

Peer influence is considered as a major determinant of tax evasion (Alm *et al.*, 2016). Thus, the findings of the current study affirm that peer influence has a significant and negative effect on income tax evasion. The finding shows the crucial part that peer influence plays a role in influencing the decision of SMEs with respect to income tax evasion. Also, the finding was found to be consistent with some extant studies in the domain of peer influence and tax evasion (Alm *et al.*, 2016; Alm & Torgler, 2006; Bobek & Hatfield, 2003; Çevik & Yeniçeri, 2013; Kirchler *et al.*, 2008). In addition, the negative result is in line with the hypothesis of the current study, whereby peer influence was considered in the context of the Palestinian SMEs by the current study to have a direct effect on their decision concerning the income tax evasion. Therefore, peer influence plays a main role in controlling the income tax evasion among the Palestinians SMEs.

The perception of an individual on issues of good governance is considered a determinant of tax evasion (Cummings *et al*. 2009). In this regard, Andriani (2015) showed how significant are the institutional trust and the rule of law towards the tax evasion decision, including the settings of a weak formal institution. The current study reveals that offering bribe to tax officials does not significantly increase tax evasion among the SMEs. However, this outcome is not consistent with several early tax evasion studies (Alm *et al.*, 2016; Torgler, 2005; Torgler & Schneider, 2007; Uslaner, 2010). In contrast, the outcome is in agreement with the findings by Imam and Jacobs (2014). The results of the current study can be justified by the strong determination of the present government to implement anti-corruption policies and promote the efficiency of its public sector. The corrupted government officials were charged and prosecuted, and the appointments were appropriately scrutinised to ensure they have uncorrupted personalities. Therefore, the above scenarios could account for the reason why bribery failed to have a significant influence on tax evasion in the context of the Palestinian SMEs.

7. Conclusion, Limitations and Future Research

Taxation is the most realistic channel for sourcing revenues by the governments in order to finance the development projects in the country. Nevertheless, tax evasion issue has undermined the government's capability to generate or maximize the expected revenue from taxation for the purpose of financing the developmental projects. In the context of Palestine, the Palestinian government depends heavily on taxation which is a major sustainable revenue source. Hence, the current study is focused on the income tax of SMEs taxpayers, they constitute a vital segment of Palestinian taxpayers. In this regard, the SMEs are potentially a large source of tax revenue generation, but they are curtailed by the high rate of tax evasion. Consequently, controlling the rate of tax evasion by SMEs will aid in raising the value of revenue generation by the government. In general, the outcome of the present study indicated that tax fairness and peer influence are negatively associated with the income tax evasion, however corruption was found to be insignificantly associated with the income tax evasion.

Consequently, the present study has contributed to the existing literature with respect to some major determinants of income tax evasion. However, the present study has some limitations, whereby the use of the structured questionnaires poses a major limitation, as it may not represent the honest answers of importers or actual behaviour. Hence, a mixed method approach is needed. Future studies may also consider broadening the model by including other unproven factors from the socio-psychological factors such as, tax knowledge, tax service quality, patriotism, religion, external audit, and trust in the government

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