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Tax System and Small Business Compliance: The Case of the Republic of Seychelles

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Abstract

The purpose of this study was to identify whether the tax system is influencing the level of small business compliance with tax laws in the Republic of Seychelles. Four variables were identified under the tax system, namely the tax rates, record keeping, tax audits and tax penalties. 360 small businesses from twelve different sectors were randomly selected to take part in this study through self-administered questionnaires. The SPSS 20.0 was used to test the strength of the relationship between the tax system and compliance levels, using the Pearson Correlation Coefficient method. The results proved that the tax rates, record keeping, tax audits and tax penalties all have a strong positive relationship with tax compliance. This implies that improvement in these variables will surely lead to improved compliance amongst small businesses.

Keywords: Seychelles tax system, small business tax compliance

1. Introduction

Governments all over the world have the responsibility of providing various public goods and services to their citizens. As a result, governments incur significant expenses on behalf of their citizens to ensure that their basic needs are being met. Since a huge sum of funds is required to do this, governments have to identify sources of funding, and one of these is through the collection of taxes. Modugu and Anyaduba (2014) define a tax as "…a compulsory levy imposed by the government on the income, profit or wealth of an individual, family, community corporate or unincorporated bodies etc. for purposes of financing public expenditures". The government exercises its powers to collect revenue through taxation legislation, which are usually performed through a Revenue Authority. According to the Organization for Economic Co-operation and Development (OECD, 2014), one of the main objectives of any Revenue Authority is to ensure that the Government is collecting taxes and duties payable in a fair and effective way, and at the same time ensuring that taxpayers maintain their trust in the revenue administration system. OECD (2014) explains that it is important for revenue authorities to ensure that the level of compliance in their respective country is high so that the country can maximize the level of revenue that is collected from taxpayers. According to Abdi (2010), tax compliance is when taxpayers abides to all tax laws and regulations and fulfill their obligations such as lodging their returns on time and paying their fair share of taxes due.

In the Republic of Seychelles, the system of self-assessment has been adopted. According to Kwai Fatt and Wong Sek Khin (2012), this is a system whereby taxpayers are responsible for calculating and reporting their tax due to the revenue authority. The revenue authority on the other hand has to ensure that taxpayers are making an honest declaration of their tax liabilities by investigating whether they are complying with tax laws, which is usually done through tax audits and enforcement activities. It can be argued that this system fosters voluntary compliance, but only if the authority has an effective system of auditing, and efficient compliance and enforcement activities. In the case of the Seychelles Revenue Commission (SRC), these units are very small and lack the required human resource capacity to perform their duties effectively, thus leaving taxpayers with the possibility of being non-compliant without being detected.

Non-compliance may be the result of taxpayers' actions such as their own negligence, lack of knowledge, intentional tax evasion or could even be the underperformance of a tax authority in fulfilling its duties effectively. They are responsible for ensuring that all taxpayers abide to the revenue laws and understand and meet their tax obligations. According to the SRC's Taxpayers Charter (2012), the obligations of taxpayers are as follows: To register as a taxpayer, submit tax returns and pay the right amount of tax on time, inform SRC of significant changes in the business, to notify SRC of any mistakes made on the returns, provide auditors with the appropriate information to conduct effective auditing. And lodge objections / appeals within the timeframe. The

Ministry of Finance, Trade and Investment introduced a new tax, falling under the normal Business Tax for small businesses to pay. The Presumptive Tax came in force in January 2013 and was designed for small businesses earning an annual turnover of less than SR 1 million per year. The Presumptive Tax removes all other obligations from the small businesses, including the Value Added Tax (VAT) and the Business Tax. Other than the Presumptive Tax, small businesses are liable to pay only their Income and Non-Monetary Benefits Tax (INMBT). The change was done to make it easier and cheaper for small businesses to meet their tax obligations. The Presumptive Tax Return is a one page document that is simple and easy to complete, compared to the Business Tax Return, where small businesses had to acquire the expertise of tax agents to complete their forms. However, regardless of the simplification that was done by the MOFTI, compliance rate has still not yet gone up to the desired level.

2. Statement of the problem

The International Finance Corporation (2007) explains that small businesses are key contributors to most economies globally. In the case of the republic of Seychelles, there are 14,222 businesses registered with the SRC (SRC Annual Report, 2014). Out of this, 3223 are registered under the small business regime. This represents 22.66% of the total number of businesses registered with the SRC. However, although the proportion of small businesses is quite significant, the amount of taxes collected from this category is only 0.1% of the total amount of revenue collected. The SRC recorded a total of SCR 1.5 billion from all tax collections, and small businesses only contributed SCR 6,846,000 (SRC Annual Report, 2014). This could be an indication that small businesses are not being fully compliant with tax laws. Small businesses not complying with tax laws means that returns are lodged late, payment is overdue, businesses are evading taxes by keeping records from audit officers, and other sorts of non-compliant behavior.

The collection of taxes has been one of the main topics in the media in the past few years. Since the beginning of the economic reform in 2008, the citizens of Seychelles have been questioning the works of the revenue authority. According to Vadde and Gundarapu (2012), one of the main problems faced by revenue authorities is the lack of officers to conduct audits and inspect whether taxpayers are complying with tax laws. This is of no exception to the Republic of Seychelles. There are a total of 14,222 businesses that have been registered with the SRC, and there are a total of only 26 officers in the Audit Unit. Table 1 indicates the number of officers allocated to each Audit Unit according to the size of businesses.

Table 1: Number of Audit Officers in each Audit Unit

Audit Unit	Number of SRC Officers
Large Business Unit	12
Medium Business Unit	9
Small Business Unit	5

Source: SRC Human Resources Division

Catching tax evaders is no easy job when facing serious lack of resources to complete the tasks. This has led to an increase in the level of non-compliant businesses, since first of all, tax payments are based on self-assessment, and secondly, taxpayers are aware that the probability of being audited is quite low. According to the Small Audit Unit Manager, only 94 audits of small businesses were conducted in the year 2014. This represents only 3% of the total number of small businesses.

According to the SRC (2014) database, the compliance rate for the year 2014 was only 33%, therefore implying that there is an urgent need to identify why some taxpayers are not compliant. The table below indicates the general rates of compliance for all business since 2010.The SRC database also recorded 1485 businesses that lodged their 2014 tax return late. This represents 46% of businesses not submitting their return on time.

Table 2: Compliance rates for 2010 to 2014.

2010	2011	2012	2013	2014
54%	45%	43%	44%	33%

Source: SRC Database

The compliance rates are alarmingly decreasing over the years, thus there is a need to identify the root cause of the problem. The most common form of non-compliance identified was late lodgment and payment of taxes due, followed by tax evasion. This is when taxpayers intentionally escape taxes for example, by declaring false income to the revenue authority. The possible reasons underlying the act of being non-compliant is what will be discussed in this study. Further investigation is required to first of all identify why small business are not making a significant contribution and secondly, why they are not complying with their tax obligations.

3. Literature review

3.1 Tax Systems

The IMF, OECD and the World Bank (2011) explain that turning a tax system into one that is simpler, more equitable and transparent remains a challenge for most developing countries. The authors further argue that an effective tax system is the key to organizing and mobilizing the country's resources to achieve economic growth. It becomes the responsibility of the tax administration to ensure that an effective and efficient tax system is in place, yet it remains one of most common challenges for many revenue authorities across the globe. A weak tax system has proven by studies conducted by Lignier and Evans (2012), Gambo et al (2014) and Nurlis (2015) to be one of the main causes of non-compliance with tax laws. Some features of a weak tax system include no integrated approach to different taxes, unfair tax laws, poor service delivery, poor governance and the presence of corruption.

3.2 Small Business and Tax Compliance

IMF (2015) defines tax compliance as "meeting all obligations imposed by the tax system". Mas'ud et al (2014) explain that there are two forms of compliance. The first one is administrative compliance, whereby taxpayers abide to tax laws and regulations, and secondly there is judicious compliance, which is the accuracy of information entered in tax returns. The authors further mention that compliance can be achieved either voluntarily by taxpayers or through enforcement activities by relevant authorities. According to Batrancea et al (2012), the Economic Theory of Tax Compliance developed by Allingham, Sandmo (1972) and Srinivasan (1973) helps in understanding some factors that will influence the level of compliance. The theory is based on three deterrent variables, namely tax rate, tax audit and probability of being detected. This theory suggests that that businesses are likely to evade taxes if the tax rates are high and probability of being audited and detected are low.

Lignier and Evans (2012) explain that complying with tax laws can have significant costs to small businesses. These would include the cost of the taxes themselves, administrative costs of computing and calculating their taxes or cost of hiring a tax agent / accountant and the time spent in handling tax matters. Because of the high cost of compliance, small businesses may decide not to comply if they perceive the benefits of compliance to be significantly lower.

3.3 Compliance Burden

PricewaterCoopers International Limited (2015) explains that governments have to understand the importance of creating a tax system that is efficient and easy to comprehend in order to promote compliance with tax laws. A tax system that is cost effective brings about many benefits such as economic growth; taxpayers comply with laws and more income is generated, which in turn promotes economic growth. According to the Small Business Administration Office (2011), compliance burden is the amount of time and money that taxpayers forgo every year in order to comply with tax laws. There are various factors that can influence compliance burden such as accessibility to information, the cost of compiling the information and the level of difficulty in computing tax documents.

Ma (2015) states that high level of compliance burden is a result of having a complex tax system. The problem becomes more prominent in cases where the country is using a self-assessment system. The burden of ensuring full compliance with tax laws is shifted on the taxpayer, therefore leading to other issues such as intentional or unintentional non-compliance with tax laws. Lignier and Evans (2012) further add that modern tax systems are known to be quite burdensome on small businesses. They explain that tax burden comprises of three main elements. Firstly, it is the tax itself and how it is being imposed on small businesses (whether on the profit or the turnover). Secondly, there are efficiency costs, also known as deadweight losses, which are market distortions that have been induced by taxes. Thirdly, the tax system has operating costs, meaning the administrative costs of complying with tax laws. This is often referred to as compliance costs.

3.4 Complexity of Tax Laws

McKerchar (2007) explains that a tax system is one that is complex if there is an excessive demand for keeping records, completing tax forms or any other burdensome obligation faced by a taxpayer. The author further identifies some factors of complexity in tax laws to be "... black letter law, grafting of legal meaning, tax reform, differentiated taxation of entities, policy framework, the progressivity of the personal tax system and the desire to address equity concerns".

By looking at some of the above factors, it can be said that there are some that might be contributing to the complexity of tax laws in the Republic of Seychelles. Firstly, the country underwent tax reforms in 2009 and the reform is still ongoing, the Presumptive Tax regime for small businesses is still new since it was introduced in 2013, some sections of tax laws are unclear and no proper interpretation is provided and finally, there is the question on whether the government is doing enough to address equity issues. The author insists that the presence of such factors would certainly create complexity in tax laws, thus leading to high level risk of non-compliance on the part of taxpayers.

4. Conceptual Framework

The study involved establishing the relationship between the tax system and the level of compliance with tax laws. The Economic Theory of Tax Compliance developed by Allingham and Sandmo (1972) was modified and used in this study. It comprises originally of the three existing elements (tax rates, tax audits and tax penalties) and modified to include a fourth variable, which is record keeping. We conceptualize the independent variable as the tax system and the dependent variable as compliance with tax laws. However, the framework does not take into consideration other elements of the tax system such as filing of registration, filing of returns, tax payments, taxpayer education and so on. We believe that the tax system in the Republic of Seychelles will influence the level of small business compliance with tax laws.

4.1 Independent variable

In this conceptual framework, the tax system is the independent variable. Although there are more elements falling under the tax system, for the purpose of this study, only a few will be discussed. The tax system includes the tax rates, record keeping of tax documentation, undergoing tax audits and facing tax penalties. Inasius and Nusantra (2015) and the GIZ Sector Programme Public Finance (2010) support the argument that there is a positive relationship between the tax system and the rate of compliance with tax laws. This means that having a weak tax structure and poor policy management and administration can directly impede compliance with tax laws, and consequently the collection of revenue.

4.1.1 Tax rates

The works of Allingham and Sandmo (1972), Fischer et al (1992) and Mas'ud et al (2014) support the suggestion that tax rates will influence taxpayers' decision to comply with tax laws. The authors argue that high tax rates contribute to non-compliance with tax laws, in the sense that they cancel out their perceived overpayment by evading taxes (e.g. declare lower income). However, other studies such as that of Modugu et al (2012) conclude that there is no relationship between tax rates and tax compliance. The mixed results in this area proves that further investigation in the field is required in order to come to a conclusion for the case of the Republic of Seychelles specifically. For the purpose of this study, the impact of tax rates on compliance will depend on whether businesses perceive the rates to be fair or not. Mas'ud et al (2014) and Barbuta-Misu (2011) argue that if taxpayers perceive the rates to be unfair, the higher the level of non-compliance. Based on the above discussion the hypothesis is stated here as:

Ho: 1.There is a positive relationship between tax rates and the rate of compliance with tax laws.

4.1.2 Record keeping

One of the obligations of businesses is to maintain accurate and up-to-date records of all their financial transactions and other tax-related documents. Guyton et al (2004) suggest that poor record keeping on the part of taxpayers will ultimately lead to non-compliance with tax laws. This is because it will have a direct impact on their income declaration as well as their ability to submit their return and make payment on time. Guyton et al (2004) explain that small businesses have to complete several activities when it comes to record keeping such as obtaining and organizing records, prepare reports for tax purposes, double check entries to ensure accuracy of information and identifying and correcting mistakes. The authors further argue that in their study, record keeping was rated as the most burdensome obligation of compliance, therefore making record keeping a potential compliance burden for taxpayers which has to be further investigated. Based on the above discussion the research hypothesis is stated here as:

Ho: 2.There is a positive relationship between record keeping and the rate of compliance with tax laws.

4.1.3 Tax audits

Modugu and Anyaduba (2011) describe audit activities as being important in increasing voluntary compliance. The works of Barbuta-Mitsu (2011) explains that if a taxpayer believes that there is a high probability of being audited, he / she will be more likely to comply with tax laws. On the other hand, if the audit probability is low, the rate of non-compliance is more likely to increase. Studies conducted by Evans et al (2005), Niu (2010) and Tagkalakis (2013), establish that there is a positive relationship between tax audit and voluntary compliance. Therefore, including audit as a probable variable influencing tax compliance proves to be very crucial. Based on the above discussion the null hypothesis is stated here as:

Ho: 3.There is a positive relationship between tax audits and the rate of compliance with tax laws.

4.1.4 Tax penalties

According to Doran (2009), Allingham and Sandmo's (1972) standard deterrence model suggests that taxpayers are likely to comply with taxes if they perceive the penalties to be higher than the cost of compliance. In a self-assessment system such as that of the Republic of Seychelles, the collection of taxes is highly dependent on voluntary compliance. Theory suggests that the strict imposition of penalties, non-compliance could be greatly reduced as proven by Doran (2009), Brbuta-Mitsu (2011) and Maciejovsky et al (2001). Therefore, it is important to include tax penalty as a factor influencing tax compliance in this particular study. Based on the above discussion the null hypothesis is stated here as:

Ho: 4.There is a positive relationship between tax penalties and the rate of compliance with tax laws.

4.2 Dependent variable

In this conceptual framework, tax compliance has been identified as the dependent variable. Tax compliance involves how a business operates in relation to the tax system; whether the business is respecting what the tax authority is expecting of them. The Republic of Seychelles depends a lot on voluntary tax compliance especially more with the introduction of the self-assessment system. Studies from various authors such as Allingham and Sandmo (1972) and Fischer et al (1992) suggest that the tax system itself, coupled with the opinions of taxpayers will influence the level of compliance with tax laws. This study seeks to establish whether this is the case for small businesses in the Republic of Seychelles.

The OECD (2001) proposes a method in which compliance can be measured in studies similar to this one. The use of questionnaires in sample surveys can assist a researcher in capturing several variables that taxpayers feel can cause them to be non-compliant. In this case, the study seeks to understand their position in terms of tax rates, their record keeping obligations, audit probability, the risk of facing severe penalties and whether any of these would influence their decision to comply. However, OECD also adds that the validity of the response may be compromised for fear or shame of admitting to being non-compliant. On the other hand, Hessing et al (1988) established that taxpayers would be very willing to share their views and opinions as long as their identity remains unanimous.

5. Methodology

Data was collected from 360 small businesses coming from 12 different business sectors. A questionnaire was used comprising of Likert type questions, whereby respondents were asked to rank their responses as 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree. The tax system comprised of four variables, namely tax rates, record keeping, tax audits and tax penalties. The summated scores for each variable was computed and measured against the scores for compliance.

5.1 Data reliability

The cronbach alpha method was used to determine the reliability of the data collected. That is, it was done to test the level of consistency in the data collected. The acceptable score for cronbach alpha is 0.70. The results of the test can be seen in Table 3. The results vary from 0.813 to 0.916, proving that the data used for this study is reliable.

Table 3: Reliability Test

VARIABLES	NUMBER OF MEASUREMENT ITEMS	CRONBACH'S ALPHA
Tax rates	4	0.813
Record keeping	4	0.877
Tax audits	4	0.903
Tax penalties	4	0.916
Tax compliance	5	0.859

Source: Research Data, 2015

6. Research Finding and Results

The findings on the relationship between the tax system and compliance levels were measured using data gathered from the questionnaire. The data collected aimed to answer the main research question: How does the tax system influence compliance with tax laws? In order to understand more about the characteristics of the respondents, we first of all provide their demographic characteristics. The next step was to measure data for each variable against data on compliance in order to understand the strength of the relationships. The Pearson Correlation Coefficient was used to carry out this test.

6.1 Respondent rates

A pilot study was first conducted with a total of 15 small businesses and the final questionnaire was distributed to another 360 respondents. Respondents were randomly picked using their Taxpayer Identification Number (TIN) from the Client Management Software and the SPSS software. A total of four employees conducted the survey by visiting each business. The response rate for the survey was 100%, thus proving the effectiveness of the method used.

7. Major Findings

7.1 Relationship between tax rates and tax compliance

It was found that there is a positive relationship between these two variables. When asked if they believe the tax rate is fair for all businesses, 81% of the respondents were not in favor. This could be due to bigger businesses under the normal business tax having the opportunity to declare their expenses and if their profit falls below SCR 150,000, they are liable to 0% tax. On the other hand, small businesses are taxed on their turnover rather than their profit; therefore they pay 1.5% tax, no matter their expenses and whether they made a loss. When asked if tax rates would influence their decision to comply with tax laws, 44% of the respondents thought so. It is important therefore to seek more understanding of taxpayers' grievances in this area and come up with ways to mitigate the risks of evasion. Table 4 below represents the responses in relation to tax rates from the questionnaire.

Table 4: Relationship between tax Rates and Tax Compliance

	Strongly agree	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
Tax rate is fair for all taxpayers	3%	7%	9%	33%	48%
Tax rates are not too high for small businesses	4%	21%	32%	31%	12%
A reduction in tax rates would result in more people paying taxes	11%	26%	20%	31%	13%
Tax Evasion because of the tax rates	8%	27%	23%	31%	13%

Source: Researcher 2015

7.2 Relationship between record keeping and tax compliance

Again, the study concluded that indeed there is a positive relationship between record keeping and tax compliance. 61% of the respondents believed that record keeping is not an easy task and it consumes a lot of their time. Another 61% believed that SRC demands in terms of record keeping are too burdensome. Furthermore, 66% have the opinion that the SRC does not provide them with sufficient time to compile their records and meet their obligations. Table 5 provides the respondents' opinions of record keeping. After noting what small businesses feel in terms of record keeping, it is clear that this responsibility is very burdensome for them, thus the need to review some of these obligations and make is easier for them to comply with tax laws.

Table 5: Relationship between record Keeping and Tax Compliance

	Strongly agree	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
Record keeping is easy and not time consuming.	4%	17%	18%	32%	29%
Record keeping brings many benefits to my business.	3%	26%	38%	29%	4%
SRC does not impose many demands in terms of record keeping.	4%	18%	18%	55%	6%
SRC provides me with sufficient time to compile my records.	6%	23%	5%	56%	10%

Source: Researcher 2015

7.3 Relationship between tax audits and tax compliance

The findings of the research conclude that there is a positive relationship between tax audits and the level of tax compliance. 51% of respondents believed that the probability of being audited is low, compared to only 29% who believed it is high. Believing that it is improbable that they would be selected for an audit would undoubtedly drive non-compliance. Furthermore, 38% believed that even when undergoing an audit, the probability of being detected is low. To make matters worse, 46% of respondents agree that it is worthwhile to understate their income. This clearly shows that there is some deficiency in audit activities conducted by the SRC, and this matter requires immediate attention. Failing to do so will worsen the level of compliance. Table 6 below shows the data collected from the questionnaire in regards to tax audits.

Table 6: Questionnaire responses in relation to tax audits

	Strongly agree	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
a) The probability of being audited is high.	5%	24%	20%	40%	11%
b)It is not worthwhile to understate my income	6%	31%	17%	38%	8%
c) The likelihood of being detected is high when being audited.	10%	12%	40%	27%	11%
d) All businesses at one point undergo auditing.	11%	21%	27%	33%	8%

Source: Researcher 2015

7.4 Relationship between tax penalties and tax compliance

The analysis concluded that the relationship between tax penalties and tax compliance is one that is positive. This means that the higher the penalties, the higher the levels of compliance. In the case of the Republic of Seychelles, the opinions of small businesses portray ineffectiveness in tax penalties, thus resulting to low levels of compliance. 47% of small businesses were not aware of tax penalties in place to combat non-compliance. 54% believed that penalties are not being strictly enforced by the SRC and 66% believe that the penalties in place are not strict enough to prevent non-compliance. Another 54% were of the opinion that the SRC is unfair in issuing penalties. More detail is provided in Table 7 below. The responses show that penalties issued by the SRC are not serving their intended purpose of preventing non-compliance, which is why compliance levels are rapidly decreasing. It is a must for the SRC to address this issue in order to further promote compliance.

Table 7: Questionnaire responses in relation to tax penalties

Percentage	**Strongly agree**	**Agree**	**Neutral**	**Disagree**	**Strongly disagree**
Taxpayers are aware of the penalties that exist.	13%	26%	15%	33%	14%
Penalties are being strictly enforced for non-compliant behavior.	12%	22%	14%	41%	13%
Penalties are strict enough to prevent non-compliance.	9%	21%	11%	53%	6%
SRC is fair in issuing penalties	6%	19%	20%	39%	16%

Source: Researcher 2015

8. Hypothesis Testing

The hypothesis of the study was tested using the Pearson Correlation Coefficient. This was used to assist in determining the strength of the relationship between the dependent and independent variables. Table 8 shows that all variables have a value above 0, meaning that a positive relationship exists between the independent variables and the dependent variables. Therefore, all four hypotheses as indicated in Table 9 have been accepted.

8.1 Pearson Correlation Coefficient

The purpose of conducting a correlation analysis was to test the strength of the relationship between the variables. As can be seen from Table 8, there is a strong positive relationship between all independent variables (tax rates, record keeping, tax audits and tax penalties) and the level of compliance with tax laws. The highest correlation was between compliance and tax audits (0.819), followed by tax penalties (0.805) and after that record keeping (0.774). The lowest correlation was between compliance and tax rates. Since they all have strong positive relationships, it can be said that improving the tax system will lead to improvement in tax compliance. However, in this case, the results show that the poor performance of the tax system is indeed influencing the low levels of compliance that the country is experiencing.

Table 8: Results for Pearson Correlation Coefficient

VARIABLES	AVERAGE SCORE OF TAX COMPLIANCE	
	Pearson Correlation Coefficient	Level of Significance
Average score of Tax Rates	.544**	.000
Average score of Record Keeping	.774**	.000
Average score of Tax Audits	.819**	.000
Average score of Tax Penalties	.805**	.000

It can also be noted that all variables are above 0.5, therefore implying that there is a strong positive relationship between tax rates, record keeping, tax audits, tax penalties and tax compliance. From the analysis output, it can be seen that the variables are significantly correlated since the p value is less than 0.05 ($p < 0.05$). The implication of identifying a positive relationship between all variables is that if the independent variables are in an upward trend, the level of compliance will also increase. On the other hand, if the independent variables move in a downwards trend, the level of compliance will also decrease.

Table 9: Summary of hypothesis testing

Hypothesis	P-Value	P-Value result	Decision
H1: There is a positive relationship between tax rates and the rate of compliance with tax laws.	0.05	0.01	Accepted H1
H2: There is a positive relationship between record keeping and the rate of compliance with tax laws.	0.05	0.01	Accepted H2
H3: There is a positive relationship between tax audits and the rate of compliance with tax laws.	0.05	0.01	Accepted H3
H4: There is a positive relationship between tax penalties and the rate of compliance with tax laws.	0.05	0.01	Accepted H4

Source: Researcher 2015

9. Discussion

From what was gathered in this study as can be seen in Appendix A, it is clear that the tax system has a strong influence over compliance with tax laws in the Republic of Seychelles. The results show that the low performance of the tax system is one of the factors contributing to non-compliance. Amongst the four variables analyzed, the strongest correlation was between tax audits and compliance. Businesses have the perception that the probability of being audited is low; and even if they are undergoing an audit, the probability of being detected is low. As a result, businesses view that not complying with tax laws is more beneficial than having to comply.

The second highest correlation was between tax penalties and tax compliance. First of all, it was seen that many businesses were not aware of the penalties that are being imposed by the SRC, therefore, they believe that such penalties are (i) not strict enough and (ii) not being properly enforced. Therefore, it cannot be agreed upon that penalties are being used for their intended purpose; to act as a deterrent for non-compliance. It was seen that record keeping also has a negative impact on compliance; businesses view it as a difficult and complex task. Furthermore, the results show that businesses believe the SRC imposes too many demands in terms of record keeping and provides them with insufficient time to fulfill their obligations. The end result would most certainly that business will fail to comply with what is expected from them.

Finally, tax rates had the lowest positive correlation with compliance. Businesses perceived that the rates are too high for small businesses and they are rather unfair when compared to larger businesses. A significant amount of respondents also held the opinion that tax rates would be the cause of non-compliance. This will certainly be the case, since the perception of unfairness would lead to non-compliance as seen in other studies.

Conclusion and policy implication

Generally, the results of this study have shown that there is a positive relationship between the tax system and the level of compliance with tax laws. Evidence from the SRC database shows that compliance levels are alarmingly low and this study has identified some possible issues with the tax system that could be encouraging non-compliant behaviour. Firstly, the tax rate is believed to be unfair, whereby bigger businesses could be benefiting from lower tax rates under the normal business tax regime. The purpose of having the Presumptive Tax regime was to encourage small businesses to be more compliant, but this is not turning out to be the case. The perception of unfairness could be a major deterrent of tax compliance. The government has to conduct a comprehensive analysis of the Presumptive and the normal Business Tax regimes and redesign the regimes as deemed necessary. Respondents of the study believe that taxes are unfair, possibly because of the gap between the two regimes. The government will have to align these two regimes to ensure that businesses falling under the lower end of the normal business tax are not paying significantly lower taxes compared to the businesses in the higher end of the Presumptive Tax regime. Businesses in the Presumptive Tax regime are taxed on their turnover; therefore, their expenses are not taken into account when computing their tax liabilities. Different business activities will have different levels of expenditure; for example, the service sectors will most probably incur lower expenditures than businesses in the manufacturing or retail sectors. Therefore, there is a need to differentiate between business sectors and the type of expenses they make. Businesses can continue being taxed at the standard rate (1.5%), but the government can also introduce a standard deduction rate depending on the sector under which the business falls. Instead of opting to move into the normal Business Tax Regime to declare their expenses and as a result face more compliance burden (e.g. record keeping, tax computation, hiring technical experts), small businesses can also be offered standard deductions in the Presumptive Tax Regime.

Secondly, most respondents perceived their record keeping requirements to be too burdensome. The positive relationship between record keeping and tax compliance can be further illustrated by the very low compliance levels recorded by the SRC. Once again, the Presumptive Tax regime has not met its intended purpose of simplifying taxpayers' obligations in terms of record keeping. The SRC should assist small businesses with their record keeping obligations by conducting unannounced on-site verification visits to ensure small businesses are keeping their records as required by the law. In cases where gaps are identified, SRC officers should provide them with proper guidance on record keeping and allow them enough time to correct their mistakes. If the business fails to do so, the SRC can issue penalties for breaching the law.

Effective tax audits have proven to be very good a measure of discouraging non-compliance, but this has not been the case for the Republic of Seychelles. According to the data collected, respondents perceive tax audit activities to be ineffective. As previously mentioned, failing to have properly executed audits especially in a self-assessment system (as is the case for the Republic of Seychelles), can motivate taxpayers to be non-compliant. The government needs to recognize the crucial role that SRC auditors play in improving compliance with tax laws. There has to be an understanding that compliance will continue to decline if the severe issue of having an under-staffed audit unit is not addressed immediately. The SRC should be allocated more funds for recruitment of audit employees in order to increase the number of audits conducted per annum. In doing so, more cases of non-compliance will be detected, non-compliant behavior will be discouraged and more revenue will be collected due to higher levels of compliance. The SRC also has to reinforce its audit capability by budgeting for training and development for audit staff. Changing legislation and taxpayer behavior coupled with a dynamic business environment will require frequent training and capability improvement. Audit employees can also undergo competency assessments to identify their strengths and weaknesses, and take necessary measures to fill in the gaps so that their skills remain up to date and relevant. Publicizing details of audit strategies can have certain legislative limitations, but the SRC can nonetheless publicize some of its audit achievements to deter non-compliance, such as making the public aware of the results of audit projects or even convictions for evasion.

Tax penalties serve the purpose of punishing non-compliance, and preventing others from acting likewise. Unfortunately, the respondents did not perceive this to be the case in the Republic of Seychelles. Their views are of the opinion that penalties are not being properly administered. The study conveyed that there is a positive relationship between tax penalties and tax compliance. Therefore, ineffective implementation of tax penalties would lead to non-compliance, as it has been seen in the Republic of Seychelles. All four independent variables measured in this study had a positive relationship with tax compliance. Therefore, if the variables are perceived to be negative in nature, the level of compliance is expected to be low. One conclusion that can be drawn is that the tax system itself is indeed causing the low levels of compliance that the Republic of Seychelles is currently experiencing. The SRC will have to review the implementation of penalties for non-compliance, since it is currently not proving to be very effective amidst small businesses. First of all, the Taxpayer Education & Service Delivery and Enforcement units have to work jointly to raise awareness on the types of penalties that exist for non-compliant behavior. This can be done through weekly articles in newspapers, brochures focusing on penalties or a specific location on the SRC website listing all penalties that exist. To address the issue of unfair penalties, the SRC has to carefully analyze the conditions under which penalties are issued; they have to ensure that taxpayers do not face penalties in circumstances whereby the law is ambiguous / unclear of what is expected of the taxpayer. A careful review of existing legislation is required and necessary amendments made. Enforcement officers have to treat all businesses equally and show no sign of preference for one over another. Failing to issue penalties as stipulated by the law will encourage non-compliant taxpayers to continue with this behavior and will also discourage compliant taxpayers to continue fulfilling their tax obligations. The SRC can therefore create a database of penalties issued that can be used as reference for issuing future penalties.

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