Fairness dimension of goods and services tax: Evidence from Indian MSMEs

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Abstract

A tax system to be called fair must assess the tax liability of each tax-payer without any biases. Most studies suggest a positive relationship between tax fairness perception and compliance behavior. This relation can only be ascertained if the factors of tax fairness are known. This study investigates the dimensions of tax fairness in India concerning the recently implemented Goods and Services Tax (GST). A survey questionnaire on tax fairness was developed and administered to a sample of 210 business people belonging to the micro, small, and medium enterprises (MSME) sector. Measures of central tendency, factor analysis, and reliability analysis identify five robust tax fairness dimensions: General Fairness, Exchange with Government, Process Equity, Inter-Group Equity, and Tax Rate Structure. By identifying the dimensions of tax fairness, the perception of tax-payers can be understood, and the factors leading to tax evasion can be curbed.

Keywords*: Tax fairness; goods & services tax; tax compliance; taxation.*

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1. Introduction

Fairness, Potter Stewart famously wrote, is what justice really is. Since promoting justice is the essence of good governance, a just and fair tax system is a matter of interest for all the parties of the social institution. A tax system is perceived as "fair" if it taxes the payers according to their "ability to pay" (Lymer & Oats, 2009). The two significant components of tax fairness (also called tax equity) are horizontal and vertical equity. While the former advocates charge of tax based on financial condition, the latter implies that tax-payers who are better off should pay in the same proportion of their earning as taxes as those who are less well off. The structure of the tax system must be analyzed to assess the fairness of any tax in particular or the taxation system as a whole. The tax structure in India is divided into direct and indirect taxes. Direct tax in India accounts for Rs. 9.45 lakh crore of total tax revenue, whereas the goods and services tax (GST) gross collection was over Rs.11.36 lakh crore for the financial year 2020-21. The revenue collection of the GST in 2020 is remarkable despite the COVID effect. The scope of the present paper is limited to identifications of the fairness dimension of GST.

Several past studies claim that tax fairness leads to positive tax compliance behavior. Tax-payers do not comply with tax laws unless they perceive the tax system as fair and just. Most of the studies on this topic address fairness and compliance issues concerning direct taxes. Very few studies have been done concerning fairness in the indirect tax regime. Past studies show that the fairness dimension is not similar in each country. Such abnormality is variation in fiscal & economic policies and trust in the government (Borrego, et al., 2013). According to

our knowledge, this is the first study conducted to determine the dimensions of tax fairness of the GST regime from an Indian perspective. This study will help the policymakers identify the factors essential to promote tax compliance in the GST system.

2. Review of Literature and Hypotheses Development

2.1 Tax Fairness

The formal concept of fairness has its roots in public finance and economics literature. The concept of tax fairness has always been a matter of discussion among researchers. The Institute on Taxation & Economic Policy (2005) considers tax fairness as the most important goal for policymakers to encourage tax compliance. Equity theory states that fairness motivates individuals (Adams, 1963). The higher the perception of fairness, the higher the compliance rate (Sinnasamy & Bidin, 2017, Abdul, 2009). Adam's theory explains that individuals do not see fairness in isolation. Instead, they look around and compare with others. A similar theory applies to tax-payers as they perceive the system to be fair only if other tax-payers are taxed fairly. Further, the extended equity theory divides the components of fairness into three categories, namely, reciprocal fairness, distributive fairness, and procedural fairness.

Reciprocal fairness predicts that individuals judge fairness based on outcomes (Bobek, 1997). Outcomes here mean incentives and punishment both. Tax-payers agree to comply more if they perceive all are treated fairly in terms of tax refunds, incentives, fines, penalties, and punishments. Distributive fairness is based on the benefits received to their contribution ratio. Individuals compare their benefits received through welfare schemes to the magnitude of the taxes paid by them (Walster, et al., 1978). Distributive fairness is achieved if the people paying a similar amount of taxes are given a similar level of facilities. Procedural fairness is one of the most relevant factors in tax compliance behavior. If the tax-payers perceive that the procedure applied in assessing their tax returns and collecting the tax revenue is fair, the tendency to comply with the tax provision increases and vice versa. To promote such procedural fairness, the government of India has gradually adopted the online payment and assessment of tax. No contact system of tax collection and assessment has improved the perception of fairness among the tax-payers. Now the tax-payers pay their taxes online through online payment channels, file all their tax return forms online, and assessment is also done online by the department. This has reduced the procedural barriers and brought transparency and ease to the tax-payers and the tax department.

Farrar, et al., (2020) attempted to investigate the influence of contextual factors, summarised from past literature, on fairness through a self-developed model and further tested it on a 501 sample to arrive at the result. Their study considered fairness as a function of the comparative analysis done by individuals before making tax-related decisions. They claim that such dimensions are not only present in the context of tax but are also an integral part of cooperative behavior.

2.2 Tax Compliance

Tax compliance can be defined as complying with the tax laws, correct computation of tax liability, timely payment of tax and filing of tax return, generating and maintaining proper tax invoices (Chatopadhyay & DasGupta, 2002). Similarly, any behavior contrary to the previous statement is noncompliant. Tax compliance has evolved into an essential topic in "economic psychology" (Barbuta-Misu, 2011). Muslichah & Graha (2018) conclude significant findings as tax fairness significantly affects tax compliance. They also found a significant positive effect of tax fairness on trust. In terms of GST provisions of India, a special section has been devoted to the GST Act, 2017. As per section- 149 of the CGST Act, 2017, every registered person shall be assigned a compliance rating based on the record of compliance based on specific parameters. The resultant rating shall be put in the public domain so that anyone transacting with the person can verify the creditability. The tax department will do the rating

on a scale of 1-10 points. The standard compliance management model has a structured framework to develop the compliance rating process. It has the following essential components:

(a) Identifying areas of non-compliance,
(b) Assigning priorities based on severity/impact
(c) Identifying the non-compliance-behavior of tax-payers
(d) Responses of department against such non-compliances, and
(e) Evaluating the impact of the measures taken.

As per the literature, studies on determinants of tax non-compliance are summed up in two models (Loo et al., 2009). These are the "Traditional Economic Deterrence Model" and the "Social and Psychological Tax Models". The first mentioned model focused on econometric variables like actual income, tax rate, declared income, penalty rate, probability of investigation, etc. to determine the tax non-compliance behavior (Allingham & Sandmo, 1972), while the second model tries to evaluate the tax compliance behavior through a theory of reasoned actions (Ajzen and Fishbein).

The present paper will help identify the areas and causes of tax non-compliance. To explain the non-compliance behavior of tax-payers, identification of its determinants is important.

2.3 Tax fairness dimension

Studies on tax fairness dimensions are minimal. Researchers like (Gerbing, 1988; Christensen & Weihrich, 1996; Pope, 2002; Richardson, 2006; Giligan & Richardson, 2005; Azmi, 2008; Bin-Nashwan et al., 2020; Loo et al., 2009) have studied the tax fairness dimension in the context of their respective countries. Gerbing (1988) did the first and most popular study on this topic. He identified five factors- "(i) general fairness/distribution, (ii) exchange with government, (iii) attitude towards taxes of the wealthy, (iv) progressive versus flat tax rate and (v) self-interest." Similar factors were identified by (Christensen & Weihrich, 1996). Giligan & Richardson (2005) conducted a cross-country study covering Hong Kong and Australia. They concluded that there is a significant difference in the perception of income tax-payers, especially in terms of "favored tax rate", "special provision", "overall fairness", and "self-interest". Richardson (2006) studied the fairness dimension in the context of Hong Kong. He empirically proved that the compliance behavior reflects the perception of tax-payers. Azmi & Perumal (2008) studied the fairness dimension in Malaysia through responses of 390 respondents. They found that fairness dimensions were different in Malaysia as only three significant fairness dimensions were identified. He justified his finding by concluding that dimensions differed from past studies due to differences in educational and cultural environments. According to (Thomas, 2012), the general fairness dimension in Barbados is the most relevant factor out of three factors (self-interest, exchange, and general fairness).

These studies are the motivation for the present study. The research gap is that none of the studies have focused on the tax fairness dimension in the Indian context. Hence this study is important to identify the factors. This research gap is also significant because GST has been recently implanted in India, replacing/subsuming 17 significant taxes and cess. So, there is a high need to study the perception of GST tax-payers.

3. Data and Methodology

The study's main objective is to determine the tax fairness dimension in the GST regime in India. Assessing the fairness dimension will help compare the fairness scenario with other countries. The data has been collected through a survey. A pilot study was conducted before the survey on 25 academicians and tax professionals during February 2021 to improve the reliability and validity of the questionnaire. The pilot study also helped in refining the questions. After the pilot study, the google form link of the questionnaire was sent to manufacturers and service providers through mails and social media platform-WhatsApp. The

respondents were selected randomly through snowball sampling. Hence, the responses were received from different states of India. The data were collected during June 2021- September 2021.

We used a self-developed questionnaire carrying 19 statements on the tax fairness dimensions. A similar questionnaire has been used by (Gerbing, 1988; Azmi, 2008), where they have empirically identified the fairness dimension but in respect of direct tax. This study is confined only to the Goods and Services Tax, 2017. We use a 5-point Likert scale ranging from "1 – Strongly Disagree to 5 - Strongly Agree" for 16 items, and "1- "Very Fair to 5-Very Unfair" for three items (Azmi, 2008).

Table 1: Statements used to measure the tax fairness dimensions

No.	Dimension	Statement
1	General Fairness	Statement no 1,2,3,4 &14
2	Self Interest	Statement no 5-8
3	Special Provision for wealthy	Statement no 17,19,20 &21
4	Tax rate	Statement no 11,12&18
5	Exchange with Government	Statement no 10,13 &16

Table- 2 shows the result of Cronbach's Alpha test, which shows that the questionnaire is reliable to use. As per past literature, Cronbach's alpha coefficient should be within the limit of 0.70 as an acceptable level of reliability. The present questionnaire showed an alpha value of 0.811, which signifies that these dimensions are reliable. Our results align with (Richardson, 2006; Azmi, 2018).

Table 2: Result of Reliability Test

Reliability	Statistics
Cronbach's Alpha	No. of Items
.811	19

4. Data analysis and interpretation

Total responses received during this study were 250, out of which 210 questionnaires were found complete and used for further analysis. The descriptive statistics of the sample collection are presented in Table 3. Most of the respondents are male (64%) and indicate fewer women's participation in the survey. Respondents between the age of 36 to 45 (31%) participated the most. Filled questionnaires were equally accepted from the manufacturing and service sectors to show comparison.

We present the mean and standard deviation of the statements for the tax fairness dimension in Table 4. The mean score of almost all the items is above 3 except for three items (Q. 5, 13, 16). It can be concluded that Indian tax-payers perceive the GST system as moderately fair. This fair perception is essential as it will further reflect their positive compliance behavior.

The mean score of all the dimensions is presented in Table 5. The process equity factor has the highest mean value with 3.98, and the tax rate structure has the least mean value with 3.07. However, all the values are above 3.

Table 6 presents the results of the factor analysis. The Kaiser-Meyer-Olkin (KMO) statistic helps identify the adequacy of the sample size for factor analysis. The range of KMO as per literature can vary from 0 to 1. It also indicates the degree to which other variables explain each variable of the set. Hair et al. (2006) suggests accepting a value > 0.5. The above table shows the KMO value as 0.676, which means the sample is adequate for factor analysis.

Table 3:Demographic Description

Item		Frequency	Percentage
Gender			
Male		134	64
Female		76	36
		210	**100**
Age (in years)			
below 25		30	14
26-35		55	26
36-45		65	31
46-55		42	20
Above 55		18	9
	Total	**210**	**100**
Educational qualification			
Matriculation		16	8
Under Graduate		68	32
Graduate		83	40
Post Graduate		23	10
Professional Degree		20	10
	Total	**210**	**100**
Sector			
Manufacturing Enterprise		105	50
Service Enterprise		105	50
	Total	**210**	**210**
Type of Organisation			
Government		45	21
Semi-government		5	2
Private		110	52
Self-Owned		50	24
	Total	**210**	**210**

Table 4: Item-wise results of descriptive statistics

Tax-Fairness Perception Items	Mean	SD
General Fairness		
Q1. For the average tax-payer	3.47	1.059
Q 2. For me personally	3.71	1.079
Q 3. Distribution among tax-payers	3.56	1.125
Q 4. Personal fair share	3.31	1.280
Q 14. Equal treatment of goods and services	3.84	1.258
Exchange with the Government		
Q 5. Fair value in return of taxes through welfare benefits	2.86	1.333
Q 6. Fairest indirect tax system possible	3.56	1.125
Q 7. Full information to the ultimate consumer	3.64	1.064
Q 8. Discouraged excessive profit through anti-profiteering rule	3.36	1.168
Process Equity		
Q 17. Comparison with the VAT system	4.11	1.043
Q 19. Physical interaction with government officials	3.67	1.176
Q 20. Online registration and E-filling of return	4.14	1.011
Q 21. Overall equity	4.01	0.985
Inter-group equity		
Q 11. Suppression of turnover	4.07	1.068
Q 12. Treatment of luxurious goods and services	4.16	1.085
Q 18. Equality among states in terms of tax revenue	3.04	1.388
Tax-rate structure		
Q 10. Tax rate slab justifies one nation, one tax theme	3.71	1.298
Q 13. The discriminated tax rate for goods and services	2.60	1.312
Q 16. Uniform rate regardless of the level of income or expenditure	2.90	1.405

Table 5:Descriptive statistics of Fairness Dimension

Factors →	GenFairness	ExchngWithGovt.	ProcessEquity	Inter-GroupEquity	TaxRateStructr
Mean	3.61	3.36	3.98	3.76	3.07
Std.Deviation	1.16	1.17	1.05	1.18	1.34
Skewness	-0.42	-0.31	0.97	0.73	-0.09
Kurtosis	-0.76	-0.69	0.57	-0.17	-0.96
Min.	1	1	1	1	1
Max.	5	5	5	5	5

Factor analysis was conducted to test whether the respondents identified similar dimensions highlighted by previous studies (Gerbing,1988; Azmi, 2018). Based on the factor analysis results, the study identified five factors – General Fairness, Exchange with Government, Process Equity, Inter-Group Equity, and Tax Rate Equity. Factor analysis was considered appropriate as the value arrived was greater than 0.30. On the other hand, the coefficient of the Bartlett test was found to reject the null hypothesis of the unitary correlation matrix. Bartlett's test of sphericity is significant with a chi-square value of 452.383. The values are within the permissible limit hence justifying the use of Factor Analysis in the present study.

Table 6: Results of Factor Analysis

Items	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
1.	.806				
2.	.788				
4.	.689				
3.	.666				
14.	.631				
5.		.680			
6.		.629			
8.		.769			
7.		.702			
20.			.761		
17.			.743		
21.			.734		
19.			.610		
18.				.859	
12.				.460	
11.				.773	
10.					.850
16.					.752
13.					.466
Eigen value	5.124	1.785	1.588	1.446	1.400
P.V.	26.967	9.394	8.358	0.7611	6.162
C. P.	26.967	36.361	44.719	52.331	59.698

Kaiser-Meyer- Olkin Measure of Sampling Adequacy: -0.676
Bartlett's Test of Sphericity (Chi-square 452.383, p<0.000)

Notes: Factor 1= General Fairness, Factor 2= Exchange with Government, Factor 3= Process equity, Factor 4= Inter-Group Equity, Factor 5= Tax rate structure. P.V. is the percent of the variance, and C.P. is the cumulative percent.
**Factor Loadings above 0.30 are displayed.

The factor analysis results revealed that the tax fairness dimensions are essential in the other jurisdictions such as the US, Australia, Hong Kong (Gilligan & Richardson, 2005), and Malaysia (Azmi, 2018) are significantly different in India. The results in the form of factors are not like Malaysia, as (Azmi, 2018) reported. Even though his study area is similar to this study i.e., Asia. Azmi (2018) identified three dimensions to tax fairness, namely, General Fairness (GenFairness), Tax Structure (Tstructure), and Self Interest (SelfInt). Further, Indians perceive that the dimensions identified by (Gerbing, 1988) as important, but the dimensions are significantly different in the Indian scenario.

5. Conclusion

The nature of indirect taxes is regressive. It often affects the poor adversely and leads to increased inequality. The adverse effect of indirect tax can be neutralized by financing the programs related to social security and welfare, especially on health and education, through indirect tax revenue. However, sufficient budget allocation is not done to such vital sectors. This is one of the reasons behind the negative attitude towards indirect tax fairness. Tax fairness is a multidimensional phenomenon, which strongly impacts compliance behavior. The present study found that most people who participated in the sample study perceive the GST system as fair when comparing their tax liability with others. Most respondents are looking forward to the new "one nation, one tax" tax system. Based on the factor analysis results, the study identified five factors – General Fairness, Exchange with Government, Process Equity, Inter-Group Equity, and Tax Rate Equity. This finding is different from the study of (Azmi, 2018; Gilligan & Richardson, 2005; Richardson, 2005). The present study concludes that Indian tax-payers are moderately satisfied with the procedural easiness brought by the GST as compared to the VAT system. Most respondents consider one nation, one tax policy equitable, fair, and justified. However, the respondents experienced high compliance costs with the introduction of GST, but they also expected this cost to reduce over time. The limitation of the present study is that only the MSME sector was covered, large business houses and service enterprises were not covered.

Further studies can be conducted for other sectors and with different tools. Through a survey, future researchers may study the relationship between tax fairness and tax compliance dimensions. The government and policymakers need to understand the perception of tax-payers and instill a sense of fairness among the public. Equal tax rate, easy online tax assessment, timely refund, fair audit, and trials are prerequisites for a fair tax system and positive tax compliance. Hence, fair perception towards the tax system is a must to promote tax compliance.

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