

The Moderating Role of Subsidy Removal on Factors Influencing SMEs Tax Compliance in Yemen

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Taxes are very important sources of government revenue and have been described by authorities as a very reliable source of funding for economic and social development. Although the government of Yemen has made a lot of effort to generate adequate tax revenue, tax compliance remains significantly low among SMEs and this has a negative effect on government revenue. The role of political instability, zakat payment, and subsidy removal in tax compliance among SMEs has not been investigated. These issues are very important and could have a strong influence on tax compliance. Therefore, this study investigates the relationship between political instability, zakat payment, and tax compliance cost with subsidy removal as a moderator of these relationships. The survey technique was utilized with questionnaires administered to 490 owners-managers of SMEs in the Yemeni manufacturing industry. Analysis was conducted on the data retrieved from respondents utilizing the SPSS and PLS software. Results from the analysis indicate that zakat payment and political instability have a significant positive relationship with the decision to comply or otherwise among SMEs. On the contrary, tax compliance cost has a negative influence on tax compliance. Furthermore, political instability positively and significantly influences tax compliance. It was also found that subsidy removal moderates the influence of political instability on tax compliance behaviour among SMEs. The findings of this research have vital policy implications that the tax authority can use in maximizing tax revenue generation and encouraging tax compliance among SMEs in Yemen and other Gulf countries.

Key words: *Tax compliance, SMEs, political instability, zakat, subsidies, compliance costs, Yemen.*

Introduction

This study was motivated by the acute need for generating tax revenue by the government of Yemen. It investigates how political instability, tax compliance costs, and zakat payments influences tax compliance behaviour among SMEs operating in the manufacturing sector in Yemen. Tax compliance constitutes a topical issue for nations around the world because they are searching for revenue to meet the demands for public goods and services (Musimenta et al., 2017). There is an increasing level of tax noncompliance with the debt crisis in the global economic environment (Ritsatos, 2014). Therefore, governments around the world are seeking ways to improve the proportion to their tax revenues to Gross Domestic Product (GDP) to achieve infrastructural and social development (Bird et al., 2008). SMEs are very important economic actors. In view of their major contribution to the gross national product and a significant component of economic activities in developing countries, SMEs are important for the economic growth (Hatega, 2007). Unfortunately, they are known for their lower tax compliance compared to other groups (Ahmed & Braithwaite, 2005). Such findings have resulted in increased interest in the behaviour of SMEs companies in terms of tax compliance (Lederman, 2003).

In Yemen, one of the reasons suggested by Ministry of Planning and International Cooperation MPIC (2018) for the low level of tax revenue in Yemen is the problem of low tax compliance among the taxpayers, especially SMEs. In view of this, Al-Faseel (2014) as well as Al-Ttaffi and Abdul-Jabbar (2016) argued that low tax compliance is a serious challenge facing Yemenis tax administration and is hindering its effective tax revenue performance. Therefore, due to low tax compliance in the country, Yemen was categorized among developing countries as backward in tax revenue generation caused by high level of tax non-compliance (Al-Faseel, 2014). Due to low compliance, Yemen loses approximately 4.7 billion dollars annually from unpaid taxes (Al-Fassel, 2014). The following statistics make the problem more evident and highlight its magnitude. According to the annual report of International Monetary Fund (2014) and the World Bank, (2018) Table 1. indicates that Yemen oil and non-oil revenue (as % of GDP) from 2007-2015.

Table 1: Yemen Oil and Non-Oil Revenue (as % of GDP) from 2007-2015

Total revenue and grants	2007	2008	2009	2010	2011	2012	2013	2014	2015
Oil revenue	22.6	27.0	15.0	17.0	17.0	14.0	13.0	11.0	11.4
Tax revenue	7.4	8.0	7.5	6.0	4.5	7.0	7.10	8.0	8.0
Grants	0.5	1.5	1.0	1.5	1.5	6.0	1.0	1.5	1.1
others	3.0	2.0	2.5	2.5	3.0	3.0	2.5	2.5	3.0
Total revenue	33.5	38.5	25.0	26.0	26.0	30.0	22.6	23.0	23.5

Source: International Monetary Fund, 2014; World Bank, 2018

As shown in Table 1, Yemen derives its income mainly from oil proceeds. In addition, The Yemeni government depends on oil proceeds for about 70% of its revenue before the crash of oil prices and the 2011 crisis which caused the government to heavily rely on tax revenues (MPIC, 2018). The motivation behind this study is to contribute to resolving this crisis by investigating factors responsible for the very low tax revenue generation facing the country. However, it is not feasible for a research project of this nature to investigate all aspects of tax revenue. Hence, this study investigated tax compliance among the small business in Yemen. This situation leads to easy evasion and avoidance of taxes due to uncertainty in the tax authority. Tax compliance cost is another key factor that can explain the relationship between tax compliance and its determinants under the Yemeni tax system. Based on deterrence theory, tax compliance costs stand to be a deterring factor to non-compliance among small business taxpayers in Yemen. This is due to the fact that small scale firms usually face huge costs in preparing, filing, and paying taxes. In many tax regimes, the cost of compliance is largely fixed, and the burden is regressive and somewhat little for big companies but constitute a high burden for small businesses (Coolidge, 2010). Thus, hiring the services of a tax consultants and additional record keeping come with extra costs, which may induce low compliance (Obaid et al., 2020).

Al-Batly (2014) states that most taxpayers in Yemen viewed paying zakat to the government on their income apart from conventional tax as an additional tax burden on their income, thus they try to under report their income for tax purposes. In addition, the way and manner the zakat is been collected, administered, and distributed also triggers some sort of dissatisfaction among the taxpayers and therefore they decide not to comply (Al-Ttaffi, 2017). Beside zakat payments and tax compliance, the removal of government subsidies on some goods is also viewed as a contributing factor for low tax compliance among the taxpayers (Al-Batly, 2014). It has increased the cost of production, transportation, and other manufacturing expenses for the SMEs (Al-Shamahi, 2015). This situation may lead to low declaration of income by the SMEs in order to minimize their tax burdens.

Tax compliance among SMEs would go a long way in addressing the tax revenue crises in Yemen and other developing countries. Therefore, this research is important in numerous ways. Firstly, the research is important to the Yemeni government, especially at this period of acute need for sustainable revenue. Secondly, according MPIC's (2018) submissions, estimated tax non-compliance level among Yemeni's SMEs are far higher than other countries that have similar income levels. Therefore, this study will help in reducing the extent of tax noncompliance in Yemen. Thirdly, this study contributes significantly to the continuing quest for workable policies to mitigate tax noncompliance among SMEs. Fourthly, this study incorporates both economic and socio-psychological perspectives in investigating SMEs tax compliance behaviour. Fifth, by investigating the direct and moderating effects of political instability, zakat payment, tax compliance cost and subsidy removal respectively, the study has

generated very useful insights. The next section is a review of relevant past studies and the development of the hypotheses. The third section describes the study's methodology. Section four presents result from the analyses while the last section discusses the findings in relation to past studies, highlights the limitations, make suggestions for future research, and concludes the paper.

Literature Review and Hypothesis Development

SMEs Tax Compliance Behaviour and Theories

SME tax compliance behaviour affects the economy and the tax system's overall efficiency and changes the allocation of resources within the economy. Alm (1999) argued that there are several factors influencing tax compliance behaviours among the taxpayers. Hence, there is no single theory that can totally explain the phenomenon. Accordingly, it is proposed that theories from other disciplines such as psychology, economics, and sociology can be employed to explain the tax compliance behaviour among the taxpayers (Alm, 1999; Jackson & Milliron, 1986). However, Jackson and Milliron (1986) and Alm (1999) suggest that tax compliance behaviour could be suitably explained from the psychological and social approach. On this note, there are many theories that are regarded to be more precise in understanding the taxpayers' compliance behavioural factors. In particular, social exchange and social influence theories. Social exchange theory suggests that human association is formed and determined by the use of comparison of alternatives based on subjective cost and benefit analysis. In this context, Blau (1964) revealed that the processes of social exchange theory are built on the essential model of social reciprocity. Therefore, it is structured on various assumptions of rational human choice between cost of not doing something and the benefit derived from doing it. In addition, social exchange theory proposed that human behaviour is a result or output of an exchange derived from practice. Cherry (2010) argued that the reasons for the exchange is to minimize cost or liability and maximize benefit or advantage. Furthermore, people are weighing up the likelihood of risk and benefit of being in their social relationships. On the other hand, social influence theory revolves around individual human behaviours. The theory proposed that individual behaviour is intentionally or unintentionally influenced by other environmental factors that will determine his willingness to perform an activity.

Accordingly, the economic approach of human attitudes shows that people commit crime provided they know that they are not going to be caught (Allingham & Sandmo, 1972). In addition, Allingham and Sandmo (1972) argued that taxpayers' decision to comply or not to comply is a rational choice in respect of uncertainty and risk i.e. taxpayer decision is based on studying the anticipated cost of compliance if they decide to comply and the benefit of not complying if decide not to. Therefore, the entire decision process is based on cost and benefit analysis and the prevailing environmental factors that shape and influence individual attitude.

They argued that some taxpayers are of view that taxes are forbidden, while others were of the opinion that it is legitimate in such a way that government has a right and legal authority to impose and collect taxes apart from zakat. Therefore, this different views and perception on taxes has influence on tax payment decision toward tax compliance behaviours in Yemen.

Political Instability and SMEs Tax Compliance Behaviour

Political instability (Uncertainty) is defined as the “propensity of a change in the executive, either by ‘constitutional’ or ‘unconstitutional’ means” (Alesina et al., 1996). Cullen et al. (2018) argued that when a higher fraction of a country’s residents holds a negative view of government, a fraction of individual/ company’s income tax is evaded. Normal changes in government creates political instability in the country (Abodher et al., 2018). Consequently, a rapid change occurs in the political, social and economic policies of governments. In this regard, taxpayers are forced to make economic decisions with the knowledge that a new government will come into power and change the policies of current government (Grossman, 1994). According to Katz and Owen (2009), the role of uncertainty becomes very important for taxpayers during economic transition. The uncertainty concerning the choice of different possible future policy of the government not only affect the economic decisions of the taxpayers, but also creates political pressures on the government. Also, during this time, and because of taxpayers’ financial decisions, economic transition significantly increases tax evasion as well as capital flight. Thus, the uncertainty is governed by one's perception, level of confidence, internal and external efficiency (Grootel, 2010).

Very few studies have been conducted on the influence of political instability on tax compliance. Some of the studies found positive relationship between tax compliance and political instability (Alm et al. 1992; Nur-tegin, 2008; D’Attoma, 2018) and some of the studies found negative relationship between tax compliance and political instability (Abodher et al., 2018; Torgler, 2003). For example, Abodher et al. (2018) found that political instability has a significant effect on tax non-compliance among self-employed Libyans. Moreover, D’Attoma (2018) concluded that individuals’ relationship with their states shapes these behavioural differences in tax compliance. If this relationship is strong, it is likely to influence taxpayers to avoid tax non-compliance. Moreover, political instability is likely to affect state’s institutions to work effectively and, ultimately, urge taxpayers to avoid tax (Filippin et al., 2013). Yemen is one of the countries that is affected by the Arab Spring, where a revolution started at the beginning of 2011. Political factors are also important to consider while investigating the determinants of tax compliance behaviour in Yemen. Moreover, this political instability largely affects the Middle East region. Therefore, this study will focus on the Middle East region, specifically, Yemen. Imam and Jacobs, (2014) stated that MENA countries lack political accountability and have entrenched inefficiency and corruption in governance. Based on the

above discussion and drawing from the socio-psychological theory, the following hypothesis is proposed:

H1: There is a positive relationship between political instability and SMEs tax compliance behaviour.

Extant literature amongst the relationship between political instability and tax compliance show relatively inconsistent findings. For instance, D'Attoma (2018), Alm et al. (1992), and Nurtegin (2008) found a significant positive relationship between political instability and tax compliance, while Abodher et al., (2018) found negative relationship between political instability and tax compliance. Based on Baron and Kenny (1986) who postulates that, where inconsistent relationship prevail, a moderating variable should be introduced to strengthen the relationship. Following Baron and Kenny postulations, the following hypothesis established.

H1a: Removal of government subsidies moderates the relationship between political instability in the government and SMEs tax compliance behaviour.

Tax Compliance Costs and SMEs Tax Compliance Behaviour

Tax compliance costs is defined as the value of resources expended by taxpayers in fulfilling their tax obligations (Sandford, 1995). According to Ariff and Pope (2002), tax compliance cost is the cost incurred by the taxpayer in meeting the conditions set out by the tax regime. Moreover, Adam and Yusof (2018) defined tax compliance cost as all costs sustained by private and corporate businesses to comply with all tax regulations, excluding the tax amount itself. Relevant to this study is the last classification, which are the external and internal compliance costs. External tax compliance costs are payments to tax experts for their services to the taxpayers, such as lawyers, accountants, tax agents or any other advisers outside the business. On the other hand, internal tax compliance costs cover all costs incurred internally in the process of complying with the tax laws, such as the costs of staff and other miscellaneous costs (Musa, 2018). More specifically, international empirical research on tax compliance costs is scarce.

Moreover, many studies have focused on only the estimation of tax compliance costs in different countries without investigating its effect on tax compliance (Blažić, 2004). Thus, the connection between tax compliance costs and tax compliance and non-compliance behaviour are still unexplored (Richardson & Sawyer, 2001). The authors emphasized the need for studies to investigate the likely connection between tax compliance costs and tax compliance variables. Some prior studies have found a negative and significant link between tax compliance and tax compliance costs (see Franzoni, 2000; 2009; Nur-ten, 2008). Other studies found a positive

between tax compliance costs and tax compliance (see Adam & Yusof, 2018; Sapiei & Kasipillai, 2013). However, Abdul-Jabbar (2009) found an insignificant relationship between tax compliance costs and tax non-compliance. In Yemen, all taxpayers operate under Self-Assessment System (SAS). Hence, the SAS shifts more responsibilities to taxpayers which makes the taxpayers to incur extra internal and external costs. However, the tax law in Yemen requires that all SMEs taxpayers have their returns endorsed by a tax consultant before it is accepted by the tax authority (Act. 17 YTA, 2010). However, given the complex and high costs of compliance due to the nature of Yemeni tax system, SMEs may find ways to evade taxes in their struggle to minimize costs and grow their businesses (Coolidge, 2010). Hence, this study expands the frontier of the literature by investigating the impact of tax compliance costs regarding SMEs tax compliance behaviour in the context of Yemen. To the best of the researcher's knowledge, no study has focused on the relationship between tax compliance costs and SMEs tax compliance behaviour in the Middle East, especially in Yemen. Based on the above discussion and drawing from the deterrence theory, the following hypothesis is proposed:

H2: There is a negative relationship between of tax compliance costs and SMEs tax compliance behaviour.

Studies on tax compliance cost and tax compliance behaviour continue to show in consistent findings as highlighted earlier. For instance, Franzoni (2000), and Yesegat (2009), found a weak negative relationship between tax compliance costs and tax compliance. Contrarily Adam & Yusof, (2018) and Sapiei & Kasipillai (2013) found positive relationship between tax compliance cost and tax compliance behaviour. Following Baron and Kenny's assertion which argued that once inconsistent findings exist, a moderating variable can be introduced to stimulates the relation amongst the constructs. This builds on additional evidence by Al- Bataly (2014) who postulated that taxpayers' receiving significant subsidies in exchange for their tax payments. Hence, an inference can made that subsidy removal can affect the relationship between tax compliance cost and tax compliance behaviour. Based evidence above which show the significance possible moderating effect of subsidy removal between the exogenous latent construct and dependent variable, the following hypothesis drawn:

H2a: Removal of government subsidies moderates the relationship between tax compliance costs in the government and SMEs tax compliance behaviour

Zakat Payment and SMEs Tax Compliance Behaviour

The problem of zakat payment is a long-standing issue that has been discussed in Islamic countries (Noor & Saad, 2016). Accordingly, Kamil (2002) discussed the problems of zakat payment by adapting the tax compliance factors. This means that zakat payment can be

investigated by adapting conventional tax compliance variables in order to understand the taxpayer's behaviours. In addition, there is a need to consider the rules and regulations that are imposed by the zakat authority in explain whether people are regarded as zakat abiding (compliance) or not and the payment should be based on zakat laws. According to Barizah and Majid (2010) and Sanep et al. (2011), there are few studies that discussed the zakat payment in view of giving the zakat through official channels or instituted authority. That is paying zakat to the officially designated zakat authority instituted in a country were Muslims are having significant number of the population. Among the early studies such as the one conducted by Liana (2018) investigated the distribution pattern of individual income tax and zakat contribution among Muslim taxpayers and the norms that motivate their tax and zakat payment behaviour. Finding of the study was that most Muslims taxpayers prefer to pay more zakat compared to the amount which they are required to pay by Islamic law.

In another study, Mohdali and Ghani et al., (2018) suggested that the institutions in charge of zakat should focus on increasing their efficiency in order to restore confidence and trust among zakat payers. In Yemen, the tax authority has different laws from zakat authority. Therefore, there is no direct administrative link between them. Accordingly, each authority collects amounts due from citizens separately from the other, hence, there is no financial overlap between them. The tax authority collects full taxes from taxpayers, regardless of whether they have paid zakat or not, and regardless of whether the amount of zakat is higher or lower than the amount of tax collected (Al-Ttaffi, 2017). Based on social exchange theory, tax compliance increases when citizens perceive corresponding benefits from government to be adequate and decreases when taxpayers perceive otherwise. Referring to the Yemeni law, tax and zakat are required to be paid in full amount. Thus, most of the companies and individuals see it as double taxation, as both tax and zakat are paid yearly by them. Based on this evidence, it is important to investigate the level of zakat payment by SMEs in Yemen for two reasons: (1) the taxpayers see it as double taxation, and (2) there is no direct benefit to the taxpayer from the payment. Based on the above discussion and the socio-psychological theory, the following hypothesis is proposed:

H3: There is a positive relationship between zakat payment and SMEs tax compliance behaviour.

Empirical evidence, with regards to the relationship between zakat payments and tax compliance, is scarce in the existing literature. However, other studies which examine the relationship between zakat payment and tax compliance will be highlighted to serve as the basis for developing the moderation hypothesis. For instance, Liana (2018) investigated the distribution pattern of zakat contribution among Muslim taxpayers and the norms that motivate their tax and zakat payment behaviour. This show the connections between zakat payments and tax compliance behaviour. Inferences can be made that subsidy removal was indicated as one

of the stimulating factors for tax compliance behaviour. This is argued by Al- Bataly (2014), who stated that subsidy removal can moderate the relationship between zakat payment and tax compliance behaviour. Based on the foregoing inferences and logical argument the following hypothesis is developed.

H3a: Removal of government subsidies moderates the relationship between zakat payment in the government and SMEs tax compliance behaviour.

Moderator: Economic Circumstances (Removal of Government Subsidies)

Baron and Kenny (1986) stated that a moderator is a variable that influence the direction and/or strength of the relationship between an independent or predictor variable and a dependent or criterion variable. Concerns about the reasons for tax evasion and other illegal actions has increased considerably in current times (Torgler & Schneider, 2007). Though some studies have tested many variables as a moderator between tax compliance and its determinants, none has used removal of government subsidies as a moderator. Economic circumstances play an important role in determining tax compliance behaviour. In fact, development can only be brought about if cooperation exists between the government and citizens. In an ideal world, developing nations require significant funds for such development and in this regard, taxation is the most significant funding source that the government can rely on (Andreas & Savitri, 2015). According to the quid pro quo argument, tax compliance is partially dependent on the taxpayers' receiving significant subsidies in exchange for their tax payments (Al- Bataly, 2014). Al-Ttaffi (2017) and Alshira'h et al. (2018) recommend the investigation of economic circumstances as a moderator in the Yemeni tax compliance environment.

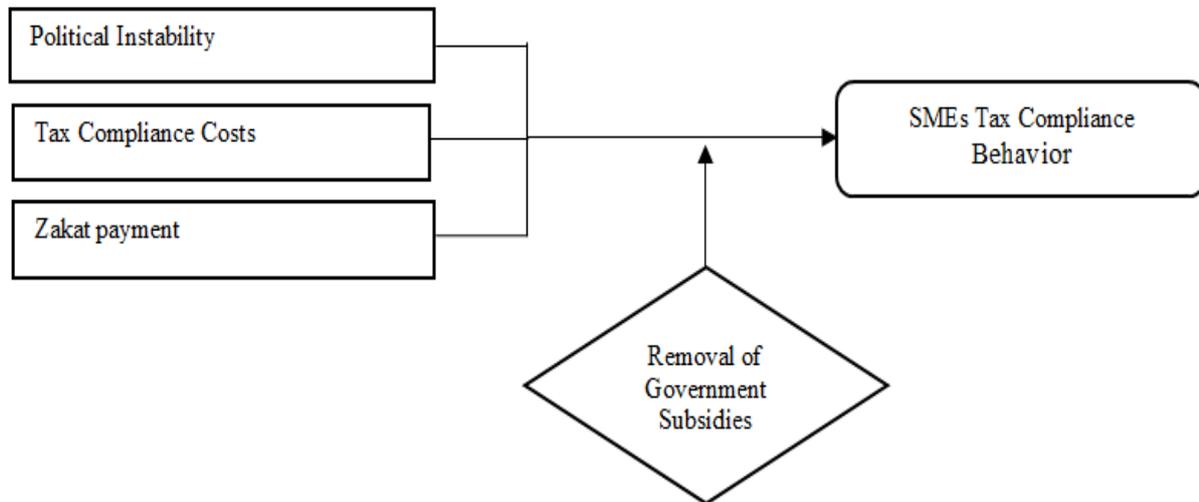
The relevant literature shows that removal of government subsidies has a significant impact on SMEs (Abdelrahim, 2014; Raji et al., 2018; Yusoff & Bekhet, 2016). However, a few prior studies have investigated the impact of removal of government subsidies on tax compliance, some of which have found a negative relationship between removal of government subsidies and tax compliance (Ayuba et al., 2015). Al-Batly (2014) stated that the Yemeni government removed subsidies from goods and services in the country as well as the fuel subsidy in 2014. Thus, taxpayers, who suffers from difficulties in terms of social's provision and other infrastructural services, may perceive that the government as not being fair to them. As a result, it may significantly affect their compliance behaviour. The current study included removal of government subsidies as a moderator of the relationships between tax compliance behaviour and its determinants because it is predicted that this variable has a potential effect on the relationship as suggested by Baron and Kenny (1986). Economic circumstances have significant positive effect on SMEs tax compliance. This study argues that the strength of the relationship between tax compliance behaviour and its determinants may be influenced by the taxpayers' perceptions on removal of government subsidies. According to this argument, it is

rational to indicate that the level of removal of government subsidies perceived by the taxpayers may affect their behaviour irrespective of whether a political instability, tax compliance costs is high, and they pay zakat. Hence, the relationship between the SMEs tax compliance behaviour and its determinants may be moderated by removal of government subsidies.

Conceptual Framework

Based on the above discussion as illustrated in prior literatures, the conceptual framework of present study constructed as in Figure1.

Figure 1. Research Framework



Methodology

Design, Population and Sample

The design of this study is cross-sectional and correlational. The population consist of approximately 27,796 SMEs in the manufactories sector registered by the Yemeni Ministry of Industry and Trade (Abdullah et al., 2018). The study utilized 377 small firms as sample in line with recommendations of Krejcie & Morgan (1970). To mitigate possible low response, which is usually the case in numerous researches on SMEs, the sample size was increased by 30%. This is justified because previous studies had a non-response rate of 67% in studies conducted among SMEs in Yemen (Al-Taffi, 2017). Hence, the sample size of the present study was increased to be 490 manufactories of SMEs. According to YMIT (2014), 82.95% of manufacturing SMEs in Yemen are located in these ten governorates in Yemen.

Measurement

The measurement used in this study was adapted from previous studies. For instance, the nine items of political instability were adapted from Grootel (2010). The seven items of zakat payment was adapted from Bidin, et al. (2013), nine items of removal of government subsidies was adapted from Abdelrahim (2014), six items of SMEs tax compliance behaviour was adapted from Gilligan and Richardson (2005) and measurement of tax compliance costs was adapted from Adapted from Abdul-Jabbar (2009) and Sandford et al (1989). Based on expert advice which suggested that a five Likert scale was adopted for this study, except for tax compliance cost where the taxpayers were asked to estimate their internal and external cost. Hence, five Likert scale was adopted for the four constructs.

Data Analysis and Findings

Measurement Model

Measurement model involves the first step to determine whether the items used to measure constructs in this study were appropriate and whether they measure what they were supposed to. It includes tests to determine cross-loading, discriminant validity and convergent validity.

Common Method Variance

When studies are conducted using a single method or data are obtained from a single source, there is a risk called common method variance (CMV) as explained by Podsakoff & Organ (1986). However, there are techniques to determine whether CMV affects a study's findings and this was performed in this study. Table 2 presents the findings.

Table 2: Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	8.661	27.067	27.067	8.661	27.067	27.067
2	3.059	9.560	36.627			
3	2.728	8.524	45.151			
4	1.924	6.014	51.165			
5	1.585	4.952	56.117			

Convergent Validity

Convergent validity determines whether the measurement items can measure what they were meant to (Chin, 1998; Cheung & Thadani, 2010). There are different ways to determine validity. One way is the convergent validity which seek to measure whether items of a construct converge on the same construct (Hair et al., 2012; Fornell & Larcker, 1981). In this study, the result of composite reliability indicate that all the constructs surpassed the threshold value of 0.7 and all the values of AVEs exceeded the 0.5 benchmark.

Table 3: Measurement model (convergent validity)

Construct	Items	Loadings	AVE	CR
Political Instability (POI)	POI2	0.792	0.562	0.884
	POI3	0.612		
	POI4	0.812		
	POI5	0.754		
	POI7	0.765		
	POI8	0.747		
Removal of Government Subsidies (RGS)	RGS1	0.789	0.574	0.915
	RGS2	0.806		
	RGS3	0.797		
	RGS4	0.755		
	RGS5	0.758		
	RGS6	0.751		
	RGS7	0.705		
	RGS8	0.690		
SMEs Tax Compliance Behaviour (STCB)	STCB1	0.810	0.530	0.870
	STCB2	0.774		
	STCB3	0.764		
	STCB4	0.669		
	STCB5	0.735		
	STCB6	0.595		
Zakat Payment (ZAP)	ZAP3	0.632	0.505	0.835
	ZAP4	0.628		
	ZAP5	0.766		
	ZAP6	0.758		
	ZAP7	0.756		

Discriminant Validity

Discriminant validity is the level to which each study's variable differs from others in the model (Duarte & Raposo, 2010). There are different approaches to establishing discriminant validity. It is established when the value of the square root of the AVE of the individual constructs are higher than the highest correlation of the construct with other constructs (Hair et al, 2019; Henseler et al., 2015). Table 6 shows that all the square roots of AVE ranged between 0.711 and 0.757 and were greater than their correlations with the other latent constructs. Figures in Table 4 indicate that the square root of AVE's is higher than all cases in the diagonal values in the respective rows and columns. Therefore, discriminant validity was attained.

Table 4: Fonnell lacker Discriminant Validity Analysis

Construct	POI	RGS	STCB	ZAP
POI	0.750			
RGS	0.418	0.757		
STCB	0.416	0.689	0.728	
ZPA	0.258	0.389	0.486	0.711

Assessment of Structural Model

The structural model seeks to determine the path coefficient. It evaluates the strength of the relationships between the IVs and the DV. Bootstrapping techniques was used in the process and about 500 bootstraps was performed (Wong, 2013).

Coefficient of Determination (R²)

This determines how much variance in the DV is explained by the combined strength of the IVs (Barclay et al., 1995). According to Hair et al. (2016), R² values of 0.75, 0.50 and 0.25 are considered substantial, moderate and weak respectively. Based on recommendations of Hair et al. (2016), the R² value of this study is considered adequate. As seen in Table 5, R² of the SMEs tax compliance behaviour was 0.580 which constitute 58 % variance explained. This is a very important contribution.

Table 5: Coefficients of Determination (R²)

Endogenous Variable	Variance Explained (R ²)	
	R ² Value	Size
SMEs Tax Compliance Behaviour	0.580	Substantial

Hypothesis Testing

Bootstrapping was performed with 1000 re-sampling from 500 cases. Additionally, the path coefficient and t-values were calculated for each hypothesis. Table 6 presents findings from the structural analysis. It shows that political instability ($\beta= 0.124$, $p<0.001$), tax compliance costs ($\beta= -0.165$, $p<0.001$) and zakat payment ($\beta= 0.256$, $p<0.001$) are significant determinants of tax compliance among SMEs and this supports H1, H2, and H3.

Table 6: Path Coefficient for Direct Effect

H	Relationship	Std Beta	T –Value	P – Value	Decision
H1	POI-> STCB	0.124	3.010	0.003*	Supported
H2	TCC-> STCB	-0.165	4.782	0.000*	Supported
H3	ZAP-> STCB	0.256	5.228	0.000*	Supported

Note: Significant at * $p < 0.001$

Economic Circumstances (Removal of Government Subsidies) as a Moderating Factor

Results of the bootstrapping test indicate that the hypothesis regarding the moderating effect of subsidy removal on the link between SMEs tax compliance and it's the independent variables was supported. Findings as shown in Table 7 is evidence that political instability ($\beta= 0.081$, $p<0.01$) is supported (H1a) with regards to the moderating role of subsidy removal. Similarly, hypothesis H2a ($\beta= -0.098$, $p<0.001$) on the moderating role on the relationship between tax compliance costs between the removal of government subsidies and SMEs tax compliance behaviour was supported. However, it was found that zakat payment and tax compliance behaviour was not moderated by subsidy removal H3a ($\beta= 0.004$, $p<0.1$).

Table 7: Path Coefficient for Moderating Effect

H	Relationship	Std Beta	T –Value	P – Value	Decision
H1a	RGS ×POI-> STCB	0.081	2.209	0.014*	Supported
H2a	RGS ×TCC-> STCB	-0.098	2.477	0.000**	Supported
H3a	RGS ×ZPA-> STCB	0.004	0.118	0.453	Not Supported

Note: Significant at * $p < 0.01$; ** $p < 0.01$

Predictive Relevance Q²

In a study of this nature, it is important to measure the predictive relevance of the constructs. It is a technique also called Stone-Geisser's Q^2 . This was done in addition to the R^2 values (Henseler et al., 2009). Hair et al. (2016) stated that the Q^2 should be measured using the blindfolding technique. Based on Hair et al. (2019) when the cross-validated redundancy measure (Q^2) value is greater than zero. Predictive relevance scores considered as 0.02 (small),

0.15 (medium) and 0.35 (large) (Hair et al., 2016). Findings from the tests in this study indicate adequate predictive relevance of the constructs.

Table 8: Construct Cross-Validated Redundancy (Q^2)

Endogenous latent variable	SSO	SSE	1-SSE/SSO
SMEs Tax Compliance Behaviour	2,232.000	1,630.839	0.269
Removal of Government Subsidies	2,232.000	1,620.312	0.274

Discussion

This research set out to investigate the relationship between political instability, tax compliance costs, and zakat payment with tax compliance behaviour among Yemeni SMEs. Additionally, the study investigated the moderating effect of economic circumstances (removal of government subsidies) on the relationship between political instability, tax compliance costs and zakat payment. The result also shows a significant relationship of political instability (uncertainty) on tax compliance behaviour among Yemeni SMEs. A possible reason might be that SMEs weigh the cost of tax compliance with what they would lose to penalties if they evade. This finding is comparable to what was found in past research (D'Attoma, 2018; Alm et al. 1992; Nur-tegin, 2008; Musa et al., 2017; Franzoni, 2000; Yesegat; 2009). Kirchler et al. (2008) explained in the synergistic climate are an ideal situation whereby there is a good relationship between SMEs and tax authorities. Taxpayers who trust in government tend to contribute more in terms of tax compliance. It is, therefore, important to have political stability to ensure adequate tax revenue in the Yemeni society. Any attempt by taxpayers to evade or avoid paying tax and zakat is an offence which is punishable for non-compliance (Obaid et al., 2020). Hence, a reasonable explanation could be that every SMEs that has wealth that reach 'Nisab' has a moral responsibility to pay zakat to the government and in supporting the poorer population.

The moderating effect of economic circumstances (removal of government subsidies) is shown to have a positive and significant relationship with the political instability and SMEs tax compliance behaviour in this study. Thus, the effect of political instability may have a significant positive impact if taxpayers who have a strong motivation to comply are surrounded by an encouraging business services and environment. Therefore, this would not affect their values, ethics, and intrinsic motivations toward SMEs tax compliance. As there is no guarantee of benefits, the SMEs do not anticipate receiving any benefits from the new government. Therefore, the conclusion is that tax compliance costs contributes towards reducing SMEs tax compliance. Taxpayers tend to maximize profit in line with the deterrence theory. The removal of subsidy does not moderate the effect of zakat payment on tax compliance perhaps because it is considered a religious obligation among owner-managers of SMEs in Yemen.

Implications

The findings of this study have practical implications in explaining the association between the variables investigated in this study. It is evident that SMEs tax compliance erode and increase tax revenues which are very essential in supporting public expenditures. It is also crucial to note that SMEs are rational and ready to comply with tax, however other factors may influence their decisions and change their behaviour and perception. In addition to understanding the factors that impact tax compliance, the study also provides a practical implication to the tax authority as well as government on how to curb the phenomenon through enacting new policies and enforcing tax laws unfailingly. Similarly, the finding is equally beneficial to tax practitioners in Yemen and developing countries.

Limitations and Future Research

This study has some limitations. Firstly, the sample used in the study considers only manufacturing SMEs and no other categories. Additionally, this study is only restricted to 10 Governorate taxpayers which represent only 10 big governorates among 21 governorates in Yemen. This makes it not convenient to generalize the result of the study due to differences in geographical locations and perceived factors that leads to tax compliance. Therefore, future studies may consider employing larger sample and other categories of taxpayers such as individual taxpayers and self-employed taxpayers. Similarly, the scope of future study should consider other regions and governorates in the country. Furthermore, the sampling technique and method of data collection employed in this study is another limitation of the study. The data and information collected from the survey may not be adequate in explaining the tax compliance phenomenon among manufacturing SMEs. Therefore, future research may consider other approaches of data collection such as mixed methods. Finally, this study investigated five factors in relation to tax compliance. Future study should consider other variables by increasing the number of factors influencing tax compliance behaviours to cover more factors that have not been considered or included here, but have conflicting result from the literature. Moreover, future studies should consider including mediating variables to investigate whether they have influence on tax compliance in Yemen.

Conclusion

This research found that political instability and zakat payment have a significantly positive influence on SMEs tax compliance. Tax compliance costs was found to negatively and significantly influence SMEs tax compliance behaviour. Furthermore, after interaction with the moderating factor, political instability has a positive and significantly negative relationship. This is also true of tax compliance costs. Therefore, the study concludes that the Yemeni tax authority should conduct political enlightenment based on the influence of removal of



government subsidies. Removal of government subsidies play a significant role in terms of SMEs perceptions and behaviours regarding tax compliance. If they perceived political instability (uncertainty), their tax compliance level would be affected. Therefore, the conclusion can be made that tax compliance costs contributes towards reducing SMEs tax compliance. The findings of this could help to provide better insight in increasing SMEs tax compliance.

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