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# Factors Affecting Compliance of Fringe Benefit Tax among Private Sector Companies in Malawi

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### Abstract

**Original Research Article** 

Tax revenue is the major source of public resources and tax compliance is vital for any government to have adequate financial resources for implementing development projects and provision of social services to its citizens. Effective strategies for enhancing tax compliance are those informed by research. One of the taxes that companies pay is Fringe Benefit Tax (FBT). This study investigated determinants of FBT compliance among private sector companies in Malawi, grounded in the Expected Utility Theory. The study employed a multistage cluster sampling technique through which 128 registered private sector companies out of 1133 were surveyed. The surveyed companies were those that are located in Malawi's three major cities of Blantyre, Lilongwe and Mzuzu, where corporate concentration is highest. Data analysis was conducted in STATA by applying a Probit model to identify factors influencing FBT compliance. The findings indicate that firm size, method of tax remittance and trust of good usage significantly affect compliance. The study recommended that MRA should enhance promotion of electronic platforms for paying taxes and consider developing a special FBT package that could be more convenient to small companies. The government should work hard towards gaining more trust from taxpayers through improvements on accountability and transparency in the way public finances are spent. With the existence of Access to Information Act, it should be easy for the public to access information on government spending there by increasing trust and tax compliance.

Keywords: Fringe benefit, tax, compliance, firm size, trust.

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# **INTRODUCTION**

The government of Malawi, like any other governments, relies on taxes for its operations and budget. However, tax revenue raised by the government always fall short of planned public spending. This prompts the government to opt for larger borrowing and seeking donor fund. This is happening while the government of Malawi is losing a lot of revenue due to non-compliance to tax. According to (Ligomeka, 2019), the loss of revenue by the government of Malawi is very significant as out of the 70,000 registered tax payers, only 32,000 pay taxes. On top of this, there are also a lot of eligible tax payers that are not registered. This is also applicable to fringe benefit tax. There might be many companies that provide fringe benefits to their employees but have not registered for fringe benefit tax in Malawi. This may indicate that the government inability to collect enough tax revenue from these companies might be from non-compliance. Each and every year the government fails to support the budget using its own funds and yet a lot of money is lost through tax non-compliance. Tax non-compliance deters the government's ability to achieve fiscal policy targets and social goals (Heitmüller *et al.*, 2019). The government of Malawi is deprived of vital resources that would finance its recurrent and developmental expenditure.

Elliot Luka (2015) defines fringe benefits as various types of non-wage compensation provided to employees in addition to their normal wages and salaries, hence fringe benefit tax is tax charged on these fringe benefits. This means that FBT is a direct tax like Pay As You Earn (PAYE) and the employer is the one who is liable to pay FBT on the total taxable value of such fringe benefits given to the employer's employee. This may constitute benefits on assets, service or reward given in kind. At the time of this research, the FBT rate in Malawi was at 30 % of the taxable value of the benefit that the employee has because of the nature of their contract with the employer. For each type of fringe benefit, there is a formula for calculating taxable value. Brown, (2017)

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states that tax compliance is viewed as the degree to which a taxpayer obliges to tax rules and regulations. Both definitions point to the fact that taxation is guided by laws.

### **Statement of the Research Problem**

The government of Malawi is losing a lot of revenue due to tax non-compliance. A lot of eligible tax payers are not even registered. This is also applicable to FBT. Each and every year the government fails to support the budget using its own funds and yet a lot of money is lost through tax non-compliance. For instance, in the 2023/2024 national budget, tax revenue was estimated at K2.2 trillion while expenditure was at K4.4 trillion and in 2024/2025 fiscal year tax revenue was estimated at K3.6 trillion against estimated expenditure of K5.9 trillion (MoF, 2024). The government of Malawi is deprived of vital resources that would finance its spending, both recurrent and developmental that forces the government to borrow which in turn lead to excessive public debts. Further to that, the tax burden is placed on very few tax payers who are subjected to high tax rates and various forms of tax. If tax compliance continues to be low, it will be very difficult for the country to achieve MW2063. MRA initiated various interventions aimed at increasing tax compliance. To this end, modern methods of paying tax have been put into use. These include online payment of tax and Electronic Fiscal Devices (EFD). The question that still stands is "what factors affect FBT compliance?". (Masiya et al., 2015) focused on determinants of tax revenue while (Kenani et al., 2021) studied compliance of Value Added Tax. There is limited published literature on FBT compliance in Malawi. This study was designed to contribute to this body of literature in Malawi so as to influence taxation policy for enhancement of tax revenue without compromising performance of businesses.

# **Objectives of the Study**

The major goal of this study was to understand Fringe Benefit Tax compliance in Malawi. Specifically, we assessed tax payers' perceptions on fringe benefit taxation in Malawi and factors that affect fringe benefit tax compliance in Malawi.

### **Empirical Literature**

This section will evaluate studies previously carried out by researchers in relation to fringe Benefit Tax, precisely on tax payers' perception, compliance and factors that affect fringe benefit tax compliance.

A study was conducted in Indonesia by Sopiyana (2022) to determine the effect of firm size on tax avoidance with profitability as a moderating variable. The research was quantitative and used data from construction sector listed on the Indonesia Stock Exchange for the 2017-2019. Data was analyzed using the regression method in the e-views. Results showed that firm size has a negative effect on tax noncompliance. In other words, large firms have high tax compliance.

Tax compliance is related to perceptions that tax payers have on various aspects of taxation in a country. Kenno (2020), conducted a study in the Ethiopian Bale Robe town on factors that affect perceptions of tax payers towards the seriousness of tax evasion. That study also investigated perceptions of tax payers on fairness of tax and usage of tax revenue by government. The study used descriptive statistics to analyse the data. The results showed that 71% of the respondent said tax was unfair and 57% said the government does not use tax revenue properly. The same study found that 73% perceived that they pay too much tax to government regardless of their income.

The extent of tax compliance attracted interest of some researchers. One research was conducted by Waziona Ligomeka in Malawi. The purpose of the study was to assess performance of African tax administration. Data was analysed by using descriptive statistics and the findings showed that out of over 70,000 registered tax payers in Malawi, only about 32,000 were active tax payers (Ligomeka, 2019).

Several researchers have studied determinants of tax compliance in various countries. Omondi Adhlambo studied factors affecting tax compliance among small scale traders in Nakuru Town of Kenya (Judith Adhiambo, 2019). The study used multivariate regression to analyse the data. Results of the study showed that tax compliance cost, awareness and technology had significant positive effects of tax compliance. (Nguyen et al., 2020) also conducted a study in Vietnam aimed at determining factors that affect cooperate income tax non-compliance. The study used a probit regression model. In that research income tax compliance was found to be affected by working capital/assets, revenue/assets, size of enterprise and other factors. Another study on factors affecting tax compliance was conducted in Nigeria in 2012 (Atawodi & Ojeka, 2012). Data was analysed using descriptive statistics and significance was tested using z-test. Results of the study showed that high tax rates had a negative effect on tax compliance.

Biru (2020) investigated factors that affect tax compliance in Ethiopia. The study used primary data from 386 Small and Medium Enterprises whereby data was analysed using descriptive and exploratory analysis. Results showed that tax rate has a statistically significant negative effect on tax compliance behavior of small and medium enterprises tax payers. Further to that, perceptions of government spending also affect tax compliance. However, the scope of that study is different from that of the current study in the sense that, (Biru, 2020) studied tax in general while the current study focuses on fringe benefit tax only.

Significantly and positively associated with tax compliance behavior of small and medium enterprises tax payers.

### **Conceptual Framework**

The empirical literature shows that there are various factors that could affect tax compliance in Malawi. The study's conceptual framework links the various factors together. Within the conceptual framework, it is also indicated that tax compliance has impact on development of a country. Certain attributes of a taxation system like tax rate can affect tax compliance. However, the usage of electronically based

Attributes of taxation system Tax rate Tax collection method Reinforcement mechanism Penalties for noncompliance Impact Infrastructure Education Health Security Tax compliance Business profits Output Attributes of tax payers Other factors Size of business Awareness Corruption Revenue level Years of business experience Attitude

**Figure 1: Conceptual Framework** 

# **MATERIALS AND METHODS**

# **Study area and Population**

The study was conducted in the three major cities of Malawi. The sample was drawn from a list of all Private Sector Companies in Malawi that were registered with the Malawi Revenue Authority. A sampling frame was provided by MRA from which a sample was drawn.

### Sample size

The size and composition of a sample has a huge contribution to the reliability of research findings. This research was quantitative in nature. Therefore, the sample size had to be statistically acceptable. The formula used for sample size determination was as in the Equation 1;

Where:

n is the sample size

Z is Z-score for confidence level. In this study, 95 percent confidence level was applied such that z was 1.96.

P is the proportion of the population that has the desired attribute. In this research the interest was on companies that comply with FBT. The true population proportion is not known for any of them. Therefore, 0.5 was used for P.

E is the margin of error. In the absence of population parameters, this study will use a margin of error equal to 0.05.

$$n = \frac{Z^2(1-p)p}{E^2}$$
$$n = \frac{1.96^2(1-0.5)0.5}{0.1^2} = 97$$

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tax payment methods demands availability of internet infrastructure apart from offering flexibility in terms of time to pay taxes.

Tax compliance can also be affected by attributes of the tax payers, be they organisations or individuals. Level of education and awareness are likely to affect compliance in such a way that if a tax payer is not aware of tax obligation, then it is difficult to comply with the said tax. Other factors that are likely to affect tax compliance include corruption and availability of unchartered roots especially for traders importing goods from other countries, See figure 1.



The sample size is adjusted for non-response at 10 percent of the computed value. This takes the sample size to 107. As additional 10 percent was added for design effect. Therefore, the final sample size was 128 Private Sector Companies. This sample size was shared among the three major cities of the country where many companies are based.

### Sampling

The sample was drawn from the population using a multistage cluster sampling method. In the sampled clusters, companies were sampled randomly. Random sampling was necessary because there are many companies and only a small proportion will be studied. This technique also opens up the possibility of generalizing the results. This study used a survey research design using employed a multistage cluster sampling technique which is a probability sampling method. The sample size was 128 businesses drawn from 1133 registered business in the three major cities of Malawi, namely Lilongwe, Blantyre and Mzuzu.

#### **Theoretical Framework**

This research is ground in the Expected Utility Theory which suggests that the taxpayer will choose declared income to maximize the expected utility of the tax evasion(Alm, 2015). The choice to pay or invade tax is made by a tax payer although payment of tax is mandatory. The characteristics of employer and other factors can affect tax payment decision. Since a tax payer can either comply or not comply with the tax obligation, tax compliance is a binary choice variable. To assess factors that affect tax compliance, a probit model was used since the dependent variable is dichotomous.

Probit model assumes that a choice is made based on unobservable Utility Index ( $I_i$ ) being affected by some variables (Gujarati & Porter, 2008). A bigger index denotes a higher probability of choice and is denoted by Equation 2:

Y

Where,

Y = tax compliance

x = logarithm of business size of the business

 $D_1$  = a dummy for tax payment method (1 for cash payment at offices and zero otherwise)

 $D_2$ = a dummy variable for trust in proper usage of tax revenue (1 for having trust and zero otherwise)  $D_3$ = a dummy variable for expected contribution of tax to development (1 for contribution and zero otherwise)

 $D_4$ = a dummy variable for payment method (1 for electronic payment and zero otherwise)

In Equation 3;

 $x_i$  is a set of observable variables related to the actual decision to make a choice about complying with tax obligation.

It is assumed that there is a critical or threshold of the index  $I_i$  \* such that if  $I_i$  exceeds  $I_i$  \*, a firm pays tax, otherwise not. The threshold  $I_i$  \*, like  $I_i$ , is not observable, but if we assume that it is normally distributed with the same mean and variance, it is possible not to estimate the parameters of the index given in equation 3, but still get some information about the unobservable index itself. Given the assumption of normality, the probability that is less than or equal to  $I_i$  \* can be computed from the standardized Cumulative Density Function (CDF) as in Equation 3.

Where:

P(Y = 1|X) means the probability that an event occurs given the value of the X, or explanatory, variable and;

 $Z_i$  is the standard normal variable.

Since P represents the probability that an event occurs, here the probability to choosing to pay tax is measured by the area of the standard normal curve from  $-\infty$  to Ii. Now to obtain information on  $I_i$  the utility index, as well as equation  $\beta_1$  and  $\beta_2$ , we take the inverse of equation 4.

#### **Empirical Model**

The probit model that was estimated in STATA based on data that were collected in this study is as in Equation 5.

 $D_5$  = a dummy variable for perception on FBT rate (1 for high tax rate and zero otherwise)

# **RESULTS AND DISCUSSION**

# **Descriptive Statistics**

Most participants reported that FBT rate was too high at 30 percent of taxable value of the fringe benefit. The study found out from the respondents their preferred FBT rate. The findings are presented in Figure 2. which is greater than 0.7, indicating that the data were

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Figure 2: Preferred Fringe Benefit Tax Rate

The results in Figure 2 above shows that 43 percent of the respondents prefer a tax rate of between 10 percent and 20 percent which is lower than the current FBT tax rate which is at 30 percent of the taxable value. This clearly indicates that companies perceive the current FBT rate as too high.

# **FBT** Compliance Level

The research wanted to assess compliance level of Fringe Benefit Tax. To begin with, participants were asked if they provide fringe benefits to their employees. Only 60 percent of the firms that participated in the study reported that they provide fringe benefits. For those who provide fringe benefit, compliance level was assessed. Table 1, shows the results.

Table 1: FBT Compliance				
Compliance	Expected percentage	<b>Observed percentage</b>		
Yes	50	43		
No	50	57		
Chi square		20.04		
p-value		0.6393		

Results in Table 1, show that FBT compliance is not significantly different from 50 percent. The Pvalue of the Chi Square goodness of fit in 0.6393 which is greater than 0.05. Hence, we fail to reject the null hypothesis of no difference between number of companies that comply with FBT and those that do not comply.

# Econometric Results of Factors Affecting FBT Compliance

To assess factors that affect FBT compliance, the research used a probit model in which the dependent variable was compliance. This variable entered the model as a binary choice variable whereby a company was considered compliant or noncompliant. The explanatory variables were firm size approximated by number of employees, trust in authorities to use tax revue properly, Contribution to development, expectation that tax revenue will contribute to national development. The coefficients from a probit model are interpreted as log of odds and log of odds are not easily understood to many readers. However, we notice that coefficients of trusts and penalties are significant at 5 percent level of significance. The researchers proceeded to estimate marginal effects of the probit model. These are interpreted as probabilities. Table 2 summarises the results of the probit model and marginal effects.

Table 2: Factors Affecting FBT Compliance					
Variables	Coefficients	<b>Marginal Effects</b>	z-value	P>z	
Log of Firm Size	0.635	0.172	2.080	0.037	
Trust of Good Usage	2.376	0.447	3.400	0.001	
Contribution to Development	0.143	0.040	0.180	0.859	
Electronic Payment	1.556	0.511	2.020	0.043	
Tax Rate	0.562	0.167	0.700	0.485	

Table 2: Factors Affecting FBT Compliance

The mean probability that a company complies with FBT is estimated at 0.77 or 77 percent. This shows

that 77 out every 100 companies are likely to comply with fringe benefit tax on average, holding all other

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factors constant. There is still a room for improvement to achieve 100 percent compliance on fringe benefit tax in the country.

### Effect of Firm Size on FBT Compliance

Firm size was approximated by number of employees. The marginal effect of firm size, in Table 2, is 0.172 and it is significant at 5 percent level of significance (p-value = 0.037 < 0.05). This means that a 1 percent increase in firm size raises the probability of compliance by 17 percent, on average, all other factors held constant. This shows that large firms have a higher probability of complying with Fringe Benefit Tax than small firms. This can be explained by economies of scale. Large firms can spread compliance cost over many employees who receive fringe benefits thereby reducing compliance cost per employee. The reduced cost enhances compliance. These results agree with the findings of a research conducted in Indonesia (Sopiyana, 2022). In that study, it was found that increase in firm size was negatively related to tax avoidance.

### Effect of Trust on Tax Compliance

Results in Table 4.12 show that the marginal effect of trust is significant at 5 percent level of significance (P-value, 0.001<0.05). Having trust raises the probability of complying with FBT by 45 percent on average holding all other factors constant. This means that Public Private Companies with Fringe Benefit Tax regulations due to trust that they have regarding proper utilisation of tax revenue by the government. This shows that companies understand that there are many public services and development projects as well as public debts that require money and tax is the major sources of government revenue. This result is not surprising because similar research findings were reported in previous studies. For instance, (Augustine & Enyi, 2020) found that trust in government has a positive relationship with voluntary tax compliance. Trust creates internal motivation for tax payers to comply with tax regulations. Where trust is lost, it becomes hard for tax authorities to collect adequate tax revenue. This also happens in Indonesia (Hadi Abdul Ghani et al., 2020) as well as Ethiopia (Biru, 2020).

### **Effect of Electronic Payment**

This research also investigated the effect of payment method (Electronic payment) on FBT compliance. Results in Table 4.8 show that the marginal effect of Electronic payment is significant at 5 percent level of significance since the p-vale is 0.043 which is less than 0.05. This means that introduction of electronic payment platforms like Msonkho online are bearing fruits. This can be explained in terms of convenience. Similar results were found in Ethiopia (Mascagni *et al.*, 2023). This is an indication that digitalisation of taxation in Malawi is bearing fruits.

### **Other Factors**

Tax rate and contribution to development do not have a significant effect on FBT compliance. It appears surprising that tax rate is not significantly influencing compliance as it is contrary to the findings of (Biru, 2020) who found that a high tax rate reduces compliance. This result suggests that the tax rate is not in the prohibitive range describes by Laffer who actually recommended 30 percent as the tax rate that maximises tax revenue (Heitmüller *et al.*, 2018). In addition to that, the current study might have found that FBT rate does not significantly affect compliance because the research focused on FBT which relates to large firms. On contribution to development, we can say that participants in this study do not think that tax revenue is really used for development projects in the country.

# CONCLUSIONS AND RECOMMENDATIONS CONCLUSIONS

The study assessed level of FBT compliance and determinants of FBT compliance among private sector companies in Malawi, grounded in the Expected Utility Theory. The study employed a multistage cluster sampling technique through which 128 registered private sector companies were sampled.

The study found that FBT rate was perceived as too high at 30 percent of taxable value of the fringe benefit and most participants preferred a rate between 10 percent and 20 percent. On FBT compliance among private sector companies in Malawi, the research found that 57 percent of the companies comply with FBT.

The key finding of the research was that FBT compliance is affected by firm size, trust in the way government would use the tax revenue and method of paying tax. However, the effects of tax rate and contribution of tax to provision of government services and development were not significant.

### **Policy Implication**

Firstly, MRA should maintain the FBT rate at 30 percent of that taxable value. Despite the rate being perceived as too high by the companies, tax rate did not show a significant effect on FBT compliance. Therefore, maintaining the rate at 30 percent would be good.

The study found that large firms have a high probability to comply with Fringe Benefit Tax. We recommend that MRA should find ways of maintaining the high compliance among large firms. For example, strengthen enforcement mechanisms, providing incentives and enhance awareness. We further recommend that MRA should find encouraging small companies that provide fringe benefits to comply with FBT.

On methods of tax remittance, the research revealed that companies that use electronic platforms to pay FBT have a higher probability of complying with this tax compared to those who use other methods. Therefore, the study recommends that MRA should enhance promotion of electronic platforms for paying taxes. The companies might consider development of tax payment calendar, automatic tax processes or outsourcing tax management services is they are not using them yet.

Trust in the way government would use tax revenue had a significant effect on FBT compliance. The research recommends that the government should work hard towards gaining more trust from taxpayers through improvements on accountability and transparency in the way public finances are spent. With the existence of Access to Information Act, it should be easy for the public to access information on government spending there by increasing trust and tax compliance. On the part of MRA, they may consider developing a special FBT package that could be more convenient to small companies.

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