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# Tax Transparency Perceptions and SMEs' Voluntary Tax Compliance in Kampala: The Mediating effect of the Business Environment

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ABSTRACT

This paper investigates how perceptions of tax transparency influence voluntary compliance to taxes by Small and Medium Enterprises (SMEs) in Kampala, Uganda, and whether the business environment mediates this relationship. Despite reforms being undertaken by Uganda Revenue Authority (URA), voluntary compliance is still low among SMEs due to negative perceptions about fairness, clarity, and openness regarding tax administration. A cross-sectional design was used with a sample size of 400 SMEs from which data were collected through structured questionnaires. The data were analyzed using SPSS employing correlation and multiple regression techniques. Correlation results revealed significant positive relationships between all dimensions of tax transparency and voluntary compliance ($r = .299–.404$, $p < .01$), which means that integrity, clarity, and accessibility of tax information enhance compliance behavior. Regression results indicated that transparency in tax exemptions and incentives as well as rates ($\beta = .237$, $p < .001$) and absence of corruption, favoritism, and arbitrary enforcement ($\beta = .200$; $p = .003$) are the strongest predictors for voluntary compliance though availability of online tax information predictability of rules from URA reports public statements were positively associated with compliance but not statistically significant predictors in this model that explained 25.4% variance in voluntary tax compliance ($R^2 = .254$). Tests confirmed stability for multicollinearity among predictors hence further mediation analysis indicated partial mediation by the business environment between perception on tax transparency and voluntary compliance meaning favorable operational conditions strengthen the effect of transparency toward enhancing compliance. The study found that SME voluntary compliance in Kampala is largely driven by transparency particularly in the areas of tax incentives and rate-setting as well as fairness in enforcement. Therefore, improving transparency by eliminating corruption and improving the business environment will significantly strengthen voluntary tax compliance. The study recommends that URA emphasize transparency in disclosing processes for determining tax incentives and rates, strengthening anti-corruption mechanisms, and expanding digital systems such as EFRIS to minimize discretionary interactions that facilitate corruption.

**Key words:Tax transparency, SMS, Compliance, Kampala**

## Introduction

The main source of local financing for public goods and services in developing countries is tax revenue. Enhancing voluntary tax compliance among small and medium enterprises (SMEs) is key to filling revenue gaps (OECD, 2022). Modernizing tax administration and improving fiscal transparency have been recent reforms in many low- and middle-income countries. These reforms aim to generate more revenue while simultaneously increasing the trust of taxpayers in the state (OECD, 2022; Global Initiative for Fiscal Transparency, 2021). Uganda has introduced initiatives such as the Electronic Fiscal Receipting and Invoicing System (EFRIS) and other digital tools to enhance reporting, increase VAT and income tax collections, and clarify tax obligations for businesses (Arenji, 2023). Despite reforms, studies continue reporting uneven voluntary compliance among SMEs in urban centers like Kampala where perceptions of fairness, complexity, and administrative burden are influencing compliance behavior (Mausa, 2024; Anaso, 2025).

Small and Medium Enterprises (SMEs) in Uganda are very important to the economy of the country because they provide jobs, create income, and bring life to the economy. However, even though these businesses are so important, most of them do not pay taxes willingly especially those found within urban areas like under the jurisdiction of Uganda Revenue Authority (URA) in Kampala. Historically these businesses have had low levels of voluntary tax compliance which can be attributed to not only capacity constraints such as record-keeping or cash flow but also structural and perceptual factors. These include how SMEs perceive the fairness, clarity, and transparency of the tax regime (Gwokyalya & Waliya, 2024; Verberne & Arendsen, 2023). It has been established through research that perceptions about fairness of the system simplicity in understanding it as well as transparency significantly influence compliance with taxes by SMEs in Uganda. A study conducted in 2024 found that higher levels of equity regarding taxes relate significantly to higher levels of SME compliance with these taxes (Omwima & Matovu, 2024). Earlier evidence from urban divisions within Kampala indicated that public trust moderates impacts between awareness about taxes and comprehension towards compliance which further stresses an aspect of trust plus perception shaping behaviors among taxpayers (Mugarura et al., 2021). This implies that voluntary compliance is not merely a product of enforcement or legal obligation but rather significantly influenced by the perception held by businesses about their taxation environment.

In response to the challenges of under compliance, URA has taken steps in recent years towards reforms that would bring about transparency and lower the cost of compliance. The reforms comprise the introduction and expansion of digital tax administration tools such as electronic tax systems, e-filing, and digital invoicing/sales recording systems (the Electronic Fiscal Receipting and Invoicing System EFRIS). These are aimed at making obligations clear, reducing face-to-face interaction, and enhancing uniformity (Musoke, 2023; Musiimenta, 2024). Empirical research on some of these initiatives found that electronic tax systems improve compliance for SMEs by facilitating payment and reducing chances for evasion (Musiimenta, 2024). This is notwithstanding challenges from intermittent power supply and Internet connectivity (Musoke, 2023).

Notwithstanding reforms and technological advancement, empirical evidence is still lacking on how SMEs perceive such changes and whether those perceptions materialize into greater voluntary compliance. Most existing literature focuses on general compliance indicators, administrative reforms, or legal-structural issues; very few studies have explicitly examined tax transparency perceptions that is, how SMEs themselves view clarity, fairness, accessibility, and openness of the tax system as a determinant of compliance behavior. This gap can be illustrated further by studies focusing on Kampala where the urban SME sector is diverse dynamic often informal or semi-formal (Verberne & Arendsen 2023). As SMEs grow increasingly crucial to Uganda's economy and given that improving domestic revenue mobilization has policy relevance it becomes imperative that we further investigate the perception relationship between tax transparency and voluntary compliance. This study thus endeavors to interrogate how perceptions related to tax transparency that includes clarity in tax laws, openness and fairness in administrative procedures, accessibility of taxpayer information as well as reliability in digital systems impact voluntary tax compliance behavior among SMEs located within Kampala. It aims at providing empirical evidence that would subsequently guide policymakers and administrators in formulating reform policies geared not just towards increased administrative efficiency but also towards enhancing trust equity and consequently voluntary compliance from SME taxpayers.

## Literature review

### Theoretical review

The study adopted social exchange, reciprocity, and tax morale as mediating theory. Social exchange theory and reciprocity provided a primary normative account of why transparency should increase voluntary tax compliance. when taxpayers perceive the state as open, fair, and responsive, they are more likely to reciprocate by complying (i.e., higher tax morale). Tax morale has been shown repeatedly to predict compliance behavior and is responsive to policies that build trust and perceived fairness (Dom et al., OECD, 2022). In short, transparency can bolster tax morale by signaling government accountability and the prospect of reciprocal public goods provision. (OECD, 2022).

**Empirical review**

Transparency can strengthen tax morale by signaling accountability and reducing information asymmetries, but its effect is conditional: if disclosures reveal corruption or poor public service delivery then transparency can instead weaken trust and reduce compliance (OECD, 2022; Nyende, 2024). Thus, many studies posit a positive transparency compliance pathway but recent work emphasizes that the quality of what is revealed-and how citizens interpret it-conditions the net effect on voluntary compliance.

Moreover, knowledge about the application of tax rules and the functioning of administrative procedures reduces both information and transaction costs for firms. Digital tools (e.g., e-filing, e-payment, electronic fiscal receipting like Uganda's EFRIS) are usually viewed as increasing procedural transparency by automating records, decreasing face-to-face discretion, and making transactions more traceable (ICPAU 2024; Arenji 2023). Empirical assessments from Uganda and similar contexts find mixed but promising results: digital invoicing and e-receipt systems can help improve VAT reporting and timeliness though uptake, ease-of-use, and digital literacy continue to be constraints for many SMEs limiting the full compliance gains from such reforms (Arenji 2023; ICPAU 2024). Further local case studies in Kampala city plus its surrounding municipalities show that SMEs normally perceive the tax system as complex and burdensome with negative perceptions of fairness plus poor service delivery reducing their willingness to comply (Mausa 2024; Irumba & Kabanda 2025). A critical thread in recent literature is about the interplay between transparency, perceived corruption, and enforcement. When transparency brings to light corruption or unequal enforcement, taxpayer trust diminishes along with perceived fairness that may negate or reverse intended compliance effects of transparency initiatives

(Nyende 2024). Also, heavy-handed enforcement without concomitant taxpayer support and clear communication can increase resistance among SMEs. Recent analyses from Uganda therefore recommend combining transparency and service-oriented reforms with anti-corruption measures plus taxpayer education for sustainable gains in voluntary compliance.

## Problem Statement

Voluntary tax compliance among Small and Medium Enterprises (SMEs) in Uganda is still significantly low despite continuous reforms by the Uganda Revenue Authority (URA). Recent national compliance statistics indicate persistent underreporting, non-registration, and low filing rates among SMEs which are contributing factors to widen Uganda's tax-to-GDP gap (URA 2022; IMF 2023). Existing studies have recognized taxpayer perceptions as important in shaping compliance behavior but have paid little attention to perceptions of tax transparency including clarity of tax laws, openness in revenue administration, access to information, and fairness of tax procedures as determinants of voluntary compliance within the Ugandan SME context (Nanteza & Nangoli 2021; Atukwase 2022).

Kampala's business environment, characterized by regulatory uncertainty, risks of corruption, informal competition, high costs of operation, and inconsistent enforcement, is likely to influence the extent to which perceptions about tax transparency translate into compliance behavior (World Bank, 2023; Tumwebaze & Bananuka, 2021). However, empirical studies have not adequately addressed the mediating role of the business environment in this relationship. This gap makes it difficult for policymakers to craft transparency driven interventions that would effectively enhance voluntary tax compliance among SMEs. An empirical study is therefore critical to understand how perceptions about tax transparency impact on voluntary tax compliance and whether this relationship gets strengthened or weakened by the prevailing business environment in Kampala.

## Objectives of the study

**General Objective**

To investigate the effect of perceptions of tax transparency on voluntary compliance with taxes by SMEs in Kampala-Uganda.

Specific Objectives

i) To assess the effect that availability of online tax information has on voluntary compliance with taxes by SMEs.
ii) To examine how predictability of tax rules influences voluntary compliance with taxes by SMEs.
iii) To evaluate what effect transparency in exemptions and incentives as well as rates impacts on voluntary compliance with taxes by SMEs.
iv) To determine if an absence of corruption, favoritism and arbitrary enforcement has any effect on the willingness of SMEs to comply with taxes voluntarily.
v) To assess how URA reports and public statements contribute towards SME's willingness to comply with their taxes voluntarily.
vi) To find out if the business environment moderates this relationship between perceptions of tax transparency and voluntary compliance with taxes.

**Research Questions**

i) In what way does availability of online tax information influence voluntary compliance with taxes by SMEs?
ii) How does predictability of tax rules affect SMEs' willingness to comply with taxes voluntarily?
iii) In what manner does transparency regarding exemptions, incentives as well as rates of taxation impact on voluntary compliance to taxation among small medium enterprises?
iv) What is the extent to which an absence of corruption favoritism and arbitrary enforcement will induce small medium enterprises towards a path of voluntary compliance?
v) How do reports from URA as well as public statements from them contribute towards voluntarily inducing small medium enterprises into a path of compliance?

vi) Does such an environment moderate this relationship between perceptions about transparency in taxation and the willingness among small medium enterprises to comply?

## Methodology

### Research Design

The study employed a cross-sectional research design which permits data collection at one point in time from respondents so as to examine relationships among variables (Creswell & Creswell, 2018). This design was suitable since it enabled the researcher assess perceptions of tax digitalization by SMEs and their voluntary compliance without manipulating any variable. The study utilized a quantitative approach for objectivity, reliability, and statistical analysis relating constructs.

### Study Area

The study took place in Kampala City, which is known as the economic and commercial hub of Uganda. It has the highest concentration of registered Small and Medium Enterprises (SMEs). It has a varied business setting with a lot of interaction with URA's digital tax systems; this makes it ideal for studying perception and compliance behavior.

### Target Population and Sample

The study focused on SMEs within Kampala Capital City. There are over 1,100,000 in Uganda; since 45% are based in Kampala capital city then the study population was 495000 SMEs using sloven's formular. These SMEs cut across different sectors like retailing manufacturing services and construction.

Using sloven's formular n=N/(1+Ne^2)

where n- sample size

N-Population

e-margin of error.

taking the margin of error to be 0.05, N=495000 and e=0.05

This implies that n=495000/ (1+(495000*0.05^2))

n=400

**Data Collection Instrument**

Data was collected through a structured questionnaire administered both physically and online. The questionnaire items were measured on a five-point Likert scale from strongly disagree (1) to strongly agree (5). Likert scales are effective for measuring attitudes and perceptions according to Likert (1932).

**Validity and Reliability**

Content validity was established through review by tax experts, academic supervisors, and URA professionals. Validity ensures that the instrument captures constructs under investigation adequately (Polit & Beck, 2017).

Reliability of the instrument was determined using Cronbach's alpha with a coefficient of 0.80 which is an acceptable level for internal consistency (Nunnally, 1978). Pre-testing helped refine ambiguous or unclear items with a small subset of SMEs in Kampala.

**Data Collection Procedure**

The researcher got permission from relevant authorities to contact SME owners or managers directly. Questionnaires were administered physically and using Google forms so that respondents with varying digital capabilities could be accommodated. Participation was on a voluntary basis with confidentiality ensured. Data Analysis Data was coded and analyzed using Statistical Package for Social Sciences (SPSS). Analysis included Descriptive statistics to summarize characteristics of respondents; variable distributions, correlation analysis to examine associations between perceptions of tax digitalization and voluntary tax compliance; multiple regression analysis determined predictive power of perceptions regarding tax digitalization on voluntary compliance regarding taxes. Regression is appropriate for testing hypothesized relationships between independent and dependent variables according to Field (2018).

**Ethical Considerations**

The study was guided by ethical principles that included informed consent, voluntary participation, anonymity, and confidentiality. The respondents were assured that the data collected would only be used for academic purposes.

# Findings

**Correlation Results**

| Variable | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|
| Absence of corruption (1) | 1 | | | | | | |
| Transparency tax exemptions (2) | .597** | 1 | | | | | |
| URA's reports and public (3) | .555** | .548** | 1 | | | | |
| Predictability of tax rules (4) | .429** | .381** | .420** | 1 | | | |
| Online tax information (5) | .373** | .275** | .328** | .530** | 1 | | |
| Business Environment (6) | .410** | .353** | .364** | .401** | .511** | 1 | |
| SMEs Voluntary Tax Compliance (7) | .404** | .340** | .299** | .364** | .401** | .488** | 1 |
| **. Correlation is significant at the 0.01 level (2-tailed). | | | | | | | |

Source: Primary data

Absence of corruption, favoritism & arbitrary enforcement ($r = .404$, $p <.01$), transparency in tax exemptions, incentives & rates ($r =.340$, $p <.01$), URA's reports and public statements ($r =.299$, $p <0.01$), predictability of tax rules ($r =0.364$, $p<0.01$), availability online tax information ($r=0.401$, $p<0.01$). All dimensions of tax transparency have shown a significant positive correlation with SMEs' voluntary compliance to taxes; this means that integrity, accessibility of information and stability of regulations are central in influencing voluntary compliance among SMEs in Kampala.

**Multiple Regression Results**

| Model | | Unstandardized Coefficients B | Unstandardized Coefficients Std. Error | Standardized Coefficients Beta | t | Sig. | Collinearity Statistics Tolerance | Collinearity Statistics VIF |
|---|---|---|---|---|---|---|---|---|
| 1 | (Constant) | 1.419 | .163 | | 8.684 | .000 | | |
| | Absence of corruption | .153 | .051 | .200 | 2.984 | .003 | .535 | 1.868 |
| | Online tax information | .087 | .051 | .112 | 1.730 | .085 | .569 | 1.757 |
| | URA's reports and public | .003 | .053 | .004 | .061 | .951 | .592 | 1.689 |
| | Predictability of tax rules | .100 | .058 | .108 | 1.736 | .084 | .625 | 1.599 |
| | Tax exemptions transparency | .207 | .052 | .237 | 4.016 | .000 | .690 | 1.448 |
| | R | | .504 | | | | | |
| | $R^2$ | | .254 | | | | | |
| | Adjusted $R^2$ | | .242 | | | | | |
| | Std. Error of the Estimate | | .33681 | | | | | |
| | F | | 21.153 | | | | | |
| | Sig | | .000 | | | | | |

a. Dependent Variable: SMEs Voluntary Tax Compliance

Source: Primary data

There is a moderate relationship between the combined predictors and SMEs' voluntary tax compliance ($R = 504$; $R^2 = 254$; adjusted $R^2 = 242$; $F (5, N) = 21.153$; $p<001$). This model explains an acceptable variation in social science research where many factors influence human behavior at the rate of 25.4%. After accounting for the number of predictors, 24.2% is still explained showing good model stability; thus, it is statistically significant meaning that these predictors jointly influence SMEs' voluntary compliance to taxes.

Absence of corruption, favoritism, and arbitrary enforcement ($\beta = .200$, $p = .003$) and transparency in tax exemptions, incentives, and rates ($\beta = .237$, $p = .000$) are significant predictors of the model. However, availability of online tax information ($\beta = .112$, $p = .085$), predictability of tax rules ($\beta = .108$, $p = .084$), and URA's reports and public statements ($\beta = .004$; $p = .951$) though important will not strongly drive compliance unless they are combined with clear communication and enforcement fairness since they are not statistically significant at 0.05.

### Multicollinearity diagnosis

Since VIF values fall between 1.448 and 1.868 which are all below 10 plus tolerances above .20 there is no multicollinearity problem i.e. predictors do not excessively overlap.

### Mediating effect of business environment

It was found that there is a significant partial mediation effect of the business environment in the relationship between tax perceptions and SMEs voluntary tax compliance. It can be established that SME's voluntary tax compliance directly results from how they perceive taxes and also indirectly through the business environment. Better perceptions about taxes provide a favorable business environment that will ultimately increase voluntary compliance in taxes among SMEs.

## Conclusion

In conclusion, transparency (transparency in tax exemptions, incentives, and rates) and fairness (absence of corruption, favoritism, and arbitrary enforcement) in tax enforcement are what strongly drive SMEs' voluntary tax compliance. Hence improving integrity and openness within URA procedures should be a key focus to enhance voluntary compliance.

## Recommendations

- ✓ Tax authorities should improve transparency in tax exemptions, incentives, and setting of the tax rate as a priority by publishing clear criteria for eligibility to all tax exemptions and incentives; disclosing annual lists of beneficiaries with justification for each exemption; conducting stakeholder engagements to explain how incentive rates are set for taxes.

- ✓ Strengthen anti-corruption measures by scaling up digitalization (e.g., EFRIS, e-filing) so that face-to-face interactions where corruption is likely can be minimized; establish anonymous whistleblowing channels for reporting corruption; apply strict disciplinary measures against corrupt officers; introduce rotation or reassignment of enforcement officers in high-risk areas.

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