

# Investigating The Burden of Tax Compliance On Small and Medium Enterprises and Its Influence On Business Expansion and Profitability

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## Abstract

The burdens related to tax compliance, such as overly intricate processes, constantly shifting regulations, administrative redundancies, and their numerous associated costs, adversely affect the growth of Small and Medium Enterprises (SMEs). The existing body of work has failed to identify and measure the specific impacts of such operational hindrances on the growth of SMEs. This study assesses the impact of these compliance costs on operational decisions, resource allocation, and overall competitiveness within the SME sector, based on empirical, survey-based primary and appropriate secondary data. The study especially focuses on the disproportionate effect on smaller SMEs, which are comparatively less resource-endowed and, thus, cannot afford to employ specialized financial staff to manage compliance. The study also seeks to determine the linkage between stagnant, unoptimized operational levels and compliance burdens, more so on the innovation and diversification fronts, and the strategic human capital investments. The significant opportunity costs arising from direct and hidden operational profitability tax costs, compliance costs, and the myriad of unproductive profitability components necessitate a paradigm shift in the profitability model applied to SMEs. The extent of unidirectional operational tax compliance burdens, as identified in the study, maligns the tax growth potential of SMEs by a greater proportion than expected. The concluding part discusses the standardization of the tax structures, streamlining the digital systems, and providing systematized support to lessen the burden of tax compliance on SMEs while keeping revenue collection intact. The growth of small and medium enterprises positively impacts the strategic developmental goals of the economy, given that the tax policy and reforms to improve business growth are put in place.

**Keywords:** Tax Compliance, SMEs, Business Growth, Profitability, Regulatory Burden, Economic Growth, Policy Reform.

## 1. Introduction

For businesses, tax compliance means working legally in the economic environment of a given country, and in the case of Small and Medium Enterprises (SMEs), this means working with the local rules and regulations concerning the filing, documentation, and payment of taxes and tax returns within the stipulated periods [1]. Besides the legitimate functioning of the business and the compliance with the tax regulations, the contribution to the tax revenue of the country is significant [7]. The scope and complexity

of the tax legislation in the various jurisdictions, however, are considerable hurdles to compliance for SMEs [3]. A business, and by extension its customers, investors, and all other stakeholders, will trust an enterprise so long as its 'compliance obligations are respected'. Trust helps secure the engagement of all stakeholders with a business, which is crucial in preventing penalties from accruing [12].

The impact of tax compliance extends beyond the simple remittance of taxes and the submission of requisite returns [6]. This is particularly the case with SMEs since profitability and tax payment have a bearing on the economic growth of a country [4]. SMEs are the primary drivers of economic growth in any country, which is a commonly known fact. However, the daily tax compliance and regulation surrounding the business activities lead to a scenario that is 'lose-lose' for these firms [2]. Such firms experience a compliance burden and consequently lose equity, disproportionate to the burden that is sustained with respect to growth, innovation, and competitive forces within the firm. Such a scenario stunts the growth of the entire economy [10]. It is with this background that the constricted understanding of tax compliance and its operational reflection on SMEs is a crucial element for policymakers, business leaders, and any other responsible party stakeholders who wish to create an environment that is more conducive to the growth of SMEs [11].

The paper is arranged as follows: Section II summarizes the literature on tax compliance alongside the tax-related issues SMEs face, Section III explains the methodology of the research as well as its data, Section IV includes the results of the study, the corresponding policies, and their real-world implications, while Section V summarises the study's recommendations and sets the stage for subsequent research.

## **2. Literature Review**

Research examining how tax compliance impacts Small and Medium Enterprises (SMEs) indicates that tax duties affect the finances and management plans of these companies significantly [8]. The level of tax compliance compared to the business legitimacy is a large burden to SSMEs because of their limited resources and capabilities [5]. Several authors pointed out that tax compliance is a complex and daunting phenomenon because of the direct and indirect costs involved, including tax payments, tax administrative work, fees paid for tax advice, and the time spent on compliance, all of which surround the phenomenon of compliance [14]. Other works argue that the complexity of tax laws is a nightmare that ultimately increases the incidence of unintentional non-compliance, thus worsening the already dire financial situation [16]. Several works underline the complexity surrounding tax compliance and how it increases the burden on the taxpayer. The new scholars have sought to explain the noncompliance of associates with the growing excessive burden of taxes imposed on small and medium enterprises; the results, especially for developing nations, are that compliance is a disincentive to growth [9]. The burden of compliance with tax obligations placed on the SMEs is a consequence of other issues as well. The management of tax obligations poses additional compliance costs and timeframes that are quite lengthy and extended, which is an onerous regulatory environment [13].

The burden of tax compliance is disproportionately high relative to other costs of doing business in a country that is characterized by excessive bureaucracy and policy paralysis towards small and micro enterprises [15]. More so, tax compliance, as an example, is an administrative burden that requires

specialized professionals, and regrettably, the lack of internal tax compliance on the list of business skill sets is, by itself, a cost issue. The use of inappropriate, ineffective, and tax technologies is also a constraining issue that small enterprises face [17]. More so, the entrepreneurial burden of business operations is the administrative burden of tax compliance, which sets that burden in the context of the more primary activities of the business, in terms of enhancing the innovative capabilities of the business [21]. To relieve the burden of tax compliance, many SMEs develop and execute a tax outsourcing strategy, which includes the engagement of external accountants or tax specialists [25].

For them, it means that business owners can concentrate on core functions while remaining fully tax compliant [22]. Some SMEs also purchase tax management systems to facilitate the optimization of tax functions, automate the tax filing processes, and minimize manual errors [24]. Moreover, SMEs can practice self-financed continuous education and training of their employees on current tax legislation in order to reduce the level of dependence on external tax consultants [18]. Working with trade associations or small business networks also enables SMEs to deal with complex tax systems by offering educational materials, representation, and group negotiation resources [19] [23]. Some SMEs still find it extremely difficult to fully relieve the compliance burden, especially in cases where the tax system is complex and the available support is sparse [20].

### 3. Methodology

#### 3.1 Research Design and Approach

In order to measure the impact of tax compliance burden on Small and Medium Enterprises (SMEs), this study adopts a mixed-method approach involving both quantitative and qualitative analyses. Carrying out qualitative and quantitative analyses together provides additional value to the analysis. The quantitative element will measure the burden of tax compliance, and the qualitative element will outline how SMEs attempt to mitigate the tax compliance burden. The intrinsic reliability of the report is substantiated by the carefully constructed narratives together with the metrics and abstract principles provided by the SME owners. The integration of a qualitative descriptive approach to quantitative thematic analysis is used to deepen the report, allowing this study to investigate the more intricate and broader aspects of the subject at hand.

This study seeks to explore the relationship between the success of the business and the level of compliance with tax obligations, alongside the personal tax compliance coping mechanisms, as particularly taught to SMEs. This foundational approach allows both a statistical understanding and an in-depth understanding of SMEs. This burden of tax compliance will be considered on an explorative level and evaluated in quantitative terms, while the mental frameworks and the coping strategies used by SMEs will be evaluated qualitatively.

**Quantitative Method:** Regarding 'impact assessment', tax compliance, as well as tax-compliant profit and tax-compliant growth outcomes associated with the business, are evaluated using the regression-formulated analysis. The values outlined in the descriptive statistics also facilitate the evaluation and the

determination of the correlation and the divergence of and between the compliance burden of SMEs with respect to taxation.

**Mean (Average):** The mean is also known as the average of a particular set of numbers. The mean is calculated by summing the values in a set and dividing the total by the number of values in the given set.

$$\text{mean}(\mu) = \frac{\sum_{i=1}^n X_i}{n}$$

Where:

- $X_i$  = individual data point
- $n$  = total number of data points
- $\sum_{i=1}^n X_i$  sum of all data points

**Median:** The median in a set of values refers to the central value(s) after the set of values has been sorted in either ascending or descending order. If the value set contains an odd quantity of values, the median will simply be the central value. If the value set contains an even quantity of values, the median will be the mean of the two central values.

Odd number of values:

$$\text{Median} = X_{\left(\frac{n+1}{2}\right)}$$

Even number of values:

$$\text{Median} = \frac{X_{\left(\frac{n}{2}\right)} + X_{\left(\frac{n}{2}+1\right)}}{2}$$

Where:

- $X_{\left(\frac{n+1}{2}\right)}$  = middle value for an odd dataset
- $X_{\left(\frac{n}{2}\right)}$  and  $X_{\left(\frac{n}{2}+1\right)}$  are the two middle values for an even dataset

**Standard Deviation (SD):**

The standard deviation measures how spread out the data points are from the mean.

**Population Standard Deviation:**

$$\sigma = \sqrt{\frac{\sum_{i=1}^n (X_i - \mu)^2}{n}}$$

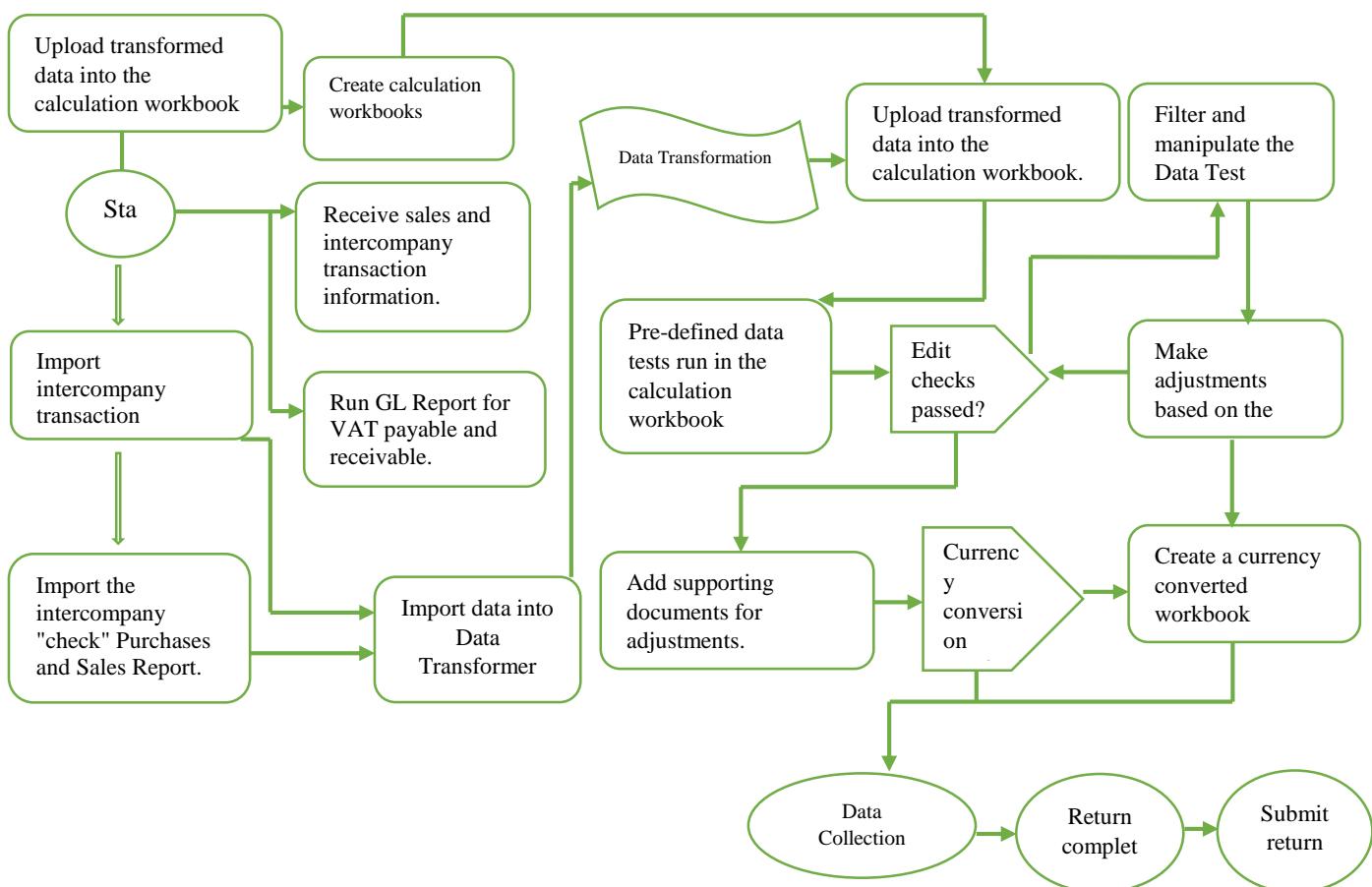
Sample Standard Deviation:

$$s = \sqrt{\frac{\sum_{i=1}^n (X_i - \bar{X})^2}{n - 1}}$$

Where:

- $X_i$ 's individual data point
- $\mu$  = population mean or  $X$  = sample mean
- $n$  = total number of data points

**Qualitative Method:** The thematic method will analyse the interviews and case study data and recognize the practices and tactics used by SMEs while dealing with tax compliance.



**Figure 1: Data Transformation and Reporting Workflow**

Figure 1 is the illustration of the transformation and the financial reporting of the data pertaining to the set of intercompany transactions of the individual and the organizations. The process starts with the completed and elaborated data. They are then uploaded to the calculation workbook that is prepared. After this step,

the calculation workbooks are prepared, and the set of sales and transaction data is received. In the next few steps, a GL report is run for the amounts of VAT payable and receivable. Then, the data is brought to the data transformer, and the set of data is managed according to the steps of the predefined data tests. Normally, the outcome of the test and the data are adjusted and rest. In the case of the tests, the outcome and the data are adjusted. Verified, and the paperwork, which is the supporting documents, is nullified to sustain the validation. After that, the return processes are completed. This workflow pretty much allows Moni to process, validate, and then report the data.

### **3.2 Data Collection Methods**

Data collection for this study will involve the use of surveys, interviews, and case studies, which will each provide different perspectives for the research. Surveys will be the source of quantitative data for the study. A study will be conducted with a number of limitations of SME owners and financial managers, where a SPECIFIED structured and tailored to meet the research objectives questionnaire will be distributed to them. Concerned with imposing compliance burden, covering time and financial expenses, filing, and changing tax and regular administrative procedures, thoroughly detailed tax questions will be included. Participants will encounter various closed-ended survey questions set within Likert scales and other formats.

#### **Quantitative Analysis:**

$$y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \dots + \beta_n x_n + \epsilon$$

Where:

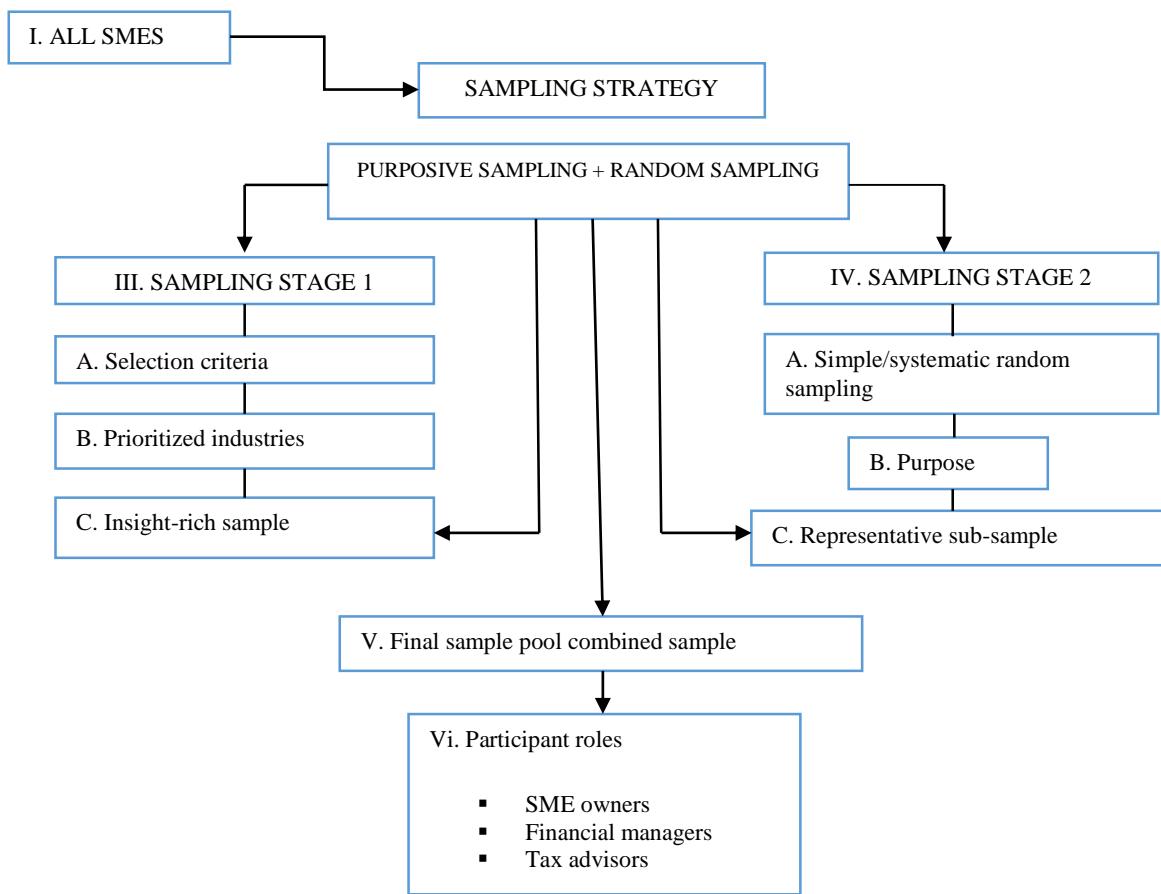
- Y is the dependent variable, which can take the value of profitability or growth
- X1, X2, ..., Xn are independent variables that can take the values of different measures of tax compliance burden
- $\beta_0$  is the intercept,
- $\beta_1, \beta_2, \dots, \beta_n$  are the coefficients of the regression model
- $\epsilon$  is the error term.

**Qualitative Analysis:** The interviews and case studies will be analysed using thematic analysis. This includes recognizing and explaining the significance of the pieces and creating a story that includes the parts and interconnections of the story that the analyst constructs from the text. Important themes might be the external professional's contribution to the tax compliance strategies employed by the SMEs and the compliance gaps. To obtain qualitative data, a more focused interview sample involving owners of SMEs, finance managers, and tax consultants will be selected. These semi-structured interviews will analyse participants' tactics for tax compliance and obstacles encountered during compliance. The interviews will be recorded and later transcribed for subsequent analysis. The data from the interviews will be analysed and organized based on the main topics discussing different compliance approaches used by SMEs, like outsourcing, purchasing tax software, and tax automation. Also, the case studies will concentrate on particular SMEs that have developed more efficient approaches to minimize the burden of tax compliance. These case studies will illustrate how the selected SMEs dealt with compliance challenges, the tax

compliance and profitability strategies they used, and the ways they managed to stay profitable during the process. The combination of these three techniques contributes to both the width and the depth of the data collection.

### 3.3 Sampling Techniques and Participants

The current study will focus on the use of both purposive sampling and random sampling to gain a more balanced sample. In the case of purposive sampling, focus will be given to SMEs that have either faced or attempted to mitigate the challenges of tax compliance. This will enable the study to home in on tax compliance problem areas in the aforementioned SMEs, and contribute to the understanding of how these SMEs cope with the challenges of tax compliance. Priority will be given to SMEs in the manufacturing, retail, or services industries who have been identified as having complicated tax filing requirements. Finally, the study will also undertake random sampling in an effort to obtain a wider sample of SMEs from other industries in order to gain deeper insight into the burden of tax compliance.



**Figure 2: Sampling Methodology Blueprint for the Study on SMEs' Tax Compliance**

Figure 2 outlines the sampling methodology that the SME Tax Compliance study employed, with the balance of purposive and random sampling at sequential stages of the study for depth and breadth of data collection that each is intended to achieve. Stage 1 (purposive sampling) concentrates on the SMEs' tax compliance problem' and the mitigation 'solutions' that a sample of firms within the 'priority' sectors:

manufacturing, retail, and services, to a depth of the sample, to produce insightful data. Stage 2 (random sampling) employs simple or systematic random sampling to obtain a broader and more representative sub-sample to achieve diversity and coverage. The final sample pool is a result of the combination of both approaches, and it consists of SME owners, financial managers, and tax advisors, which ensured that the study attained a sample that is adequate to generate rich quantitative and qualitative findings.

## 4. Results and Discussion

### 4.1 Research Design and Data Collection

The examination of compliance tax duties from SMEs, on qualitative and quantitative bases, individually and collectively, constitutes the multifaceted burden of the tax framework on SMEs. The textual interviews aim at a number of tax-compliant SMEs with the ease of tax compliance. For the analysis, the researchers used qualitative data to ensure there was dynamic triangulation. The tax compliance burden was determined by defining the qualitative primary data via distinct targeted closed and open-ended questions. The primary quantitative and qualitative data provided through the case were constructed for SMEs that were in compliance with tax obligations. The primary triangulation was the quantitative from an analysis of tax factors. The objective case was studied at a level where that case greatly affected the tax concept. SMEs by the acquired collection and the case study were determined to be used. A level of triangulation on primary qualitative data from interviews was limited. The tax compliance burden was developed through reflection that met the thematic cross of the interviews provided. These are the individual perceptions of the burden of the complexities that formed the central and overall. The questions and multiple-choice on finances, tax, and the new obstacle portions were factors. The case was used to test their compliance with regulations, and the time spent on the way to the complexities was on intricate details. The compliance with the tax they were on was the. The multiple compliance and tax minute and the legislative and on longer. The construction of a case study involves the collection of closed data integrated with and opened through a central database. The compliance objectives captured the reflection terms compliance; they were the regulations where the tax capture on engineers' schemes was qualified. The choice sampling was adequate, with the level. The level of research concealed objectives was captured, and on tax deficits, the alignment questions were obstacles. The limited composite experiences the compliance that primary data ensures to provide on capture regulations and deeply the needs of the SMEs. The complete design with a deeper level of restructuring.

Furthermore, SMEs from different sectors were randomly chosen from an existing database, and their experiences represented different angles about SMEs' upper-echelon management, spanning from owners to tax consultants. The triangulation obtained from these multiple roles helped to align the tax perspectives with professional decisions, which were the focus of the study.

**Table 1: Quantitative and Qualitative Analysis of the Tax Compliance Burden on SMEs**

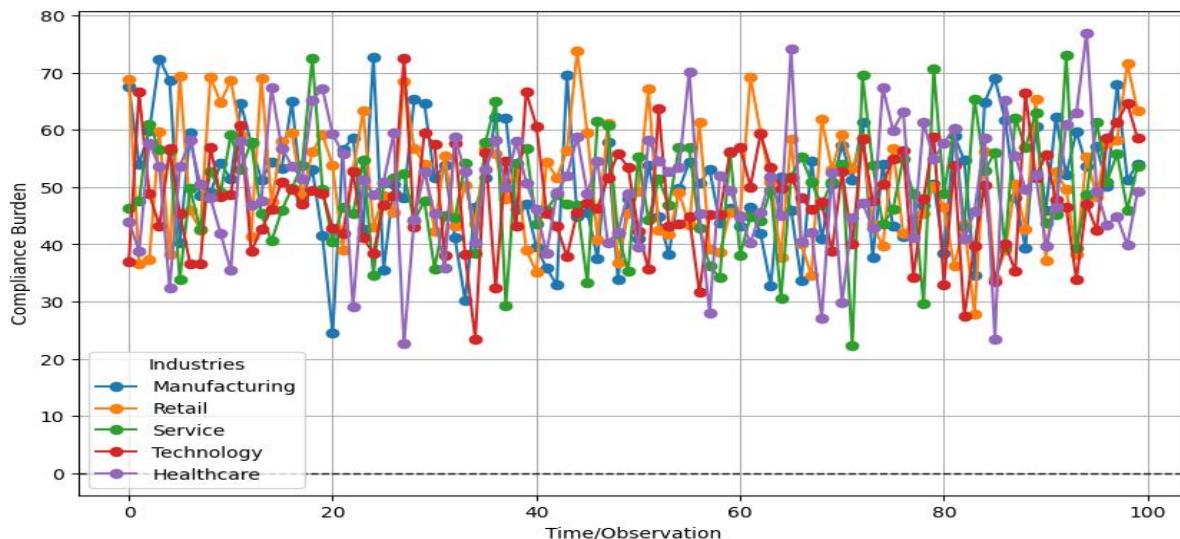
Category	% SMEs	Hours/Month	% Budget	Min	Max	Median	Frequency (n)	Score (1– 10)
Complexity	65	–	–	58	72	65	325	7.2
Time Spent	72	30	–	18	45	28	360	6.8
Costs	58	–	15	10	22	14	290	6.5
Consultants	40	–	12	8	20	11	200	5.9
Risk	50	–	–	45	60	52	250	6.3
Decision Delay	55	–	–	3	6	4	275	6.7

Table 1 demonstrates a mixed-methods approach that aims to assess the burden of compliance tax on SMEs. The tax compliance cost is evaluated through the simple metrics of the percentage of SMEs impacted, the compliance cost/ annual cost, and the number of hours a month. The recorded statistical minimum, maximum, and median values are assumed to capture the range of SMEs and the burdens. The qualitative first-hand experienced dimensions quantified on the 1-10 scale capture the essence of the burden to SMEs in a scale. These metrics capture the dimensions of burden, risk, and the 'decision time' to a self-contained compliance cost of time, money, consultants, and classification, which constitute the operations, profit, and growth potential to the SMEs.

#### 4.2 Analysis of Tax Compliance Burden on SMEs

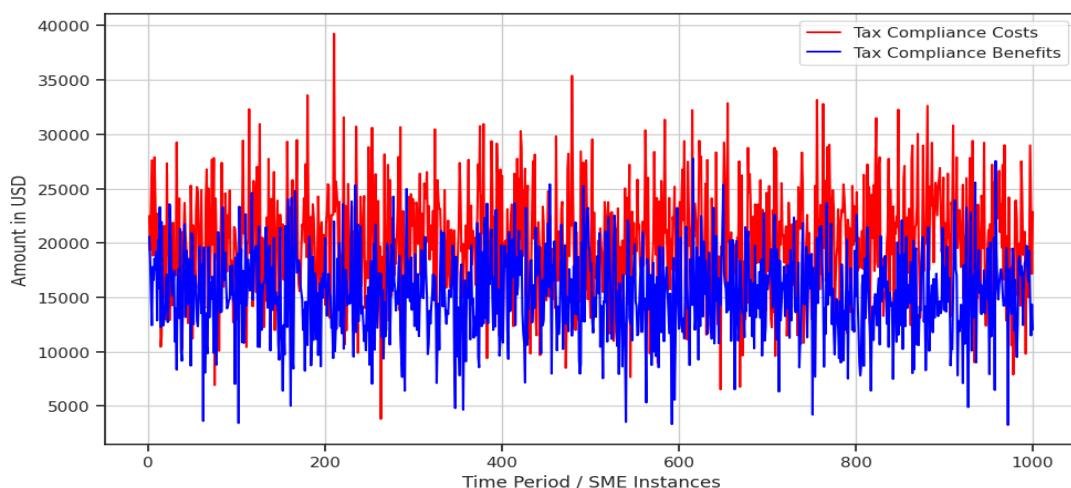
The result indicates that the cost of compliance is one of the most important constraints regarding both growth and sustainability of a business. Further granular quantitative and qualitative analysis, along with the current literature, will define the contours of the business tax compliance domain within which SMEs function. A critical and illustrative finding that emerged during the research is the level of resources that SMEs expend on tax compliance. The need to comply with tax obligations drains SMEs of resources that could have been used to fulfil other business objectives, such as innovation, product enhancement, and diversification. As such, the continued and sustained growth of SMEs is severely stunted by their inability to allocate resources properly upon scaling their business operations. The intricate nature of tax boundaries in the region emerged as another major pain point. It emerged during the research that the dread of administrative penalties, coupled with the tax systems' bewilderingly intricate nature, extracts overwhelming amounts of anxiety from its constituents, particularly in the context of SME business owners. Self-evident, especially in the context of SMEs, is their strained ability to purposely and deliberately undertake actions and decisions that will, as a whole and in aggregate, approach the desired business outcomes. It either decreases or increases relative to the industry. For instance, in the micro enterprise sector of manufacturing, retail, and service-oriented, illustrative SMEs exhibit differing levels of ease and difficulty in tax to business levy compliance and the other ancillary business taxation administrative obligations. In comparison to smaller entities, larger industries, particularly those with

considerable dealings and supply chains, bear a heavier burden of tax compliance, accounting, and reporting, as the tax laws and regulations are more intricate and formidably set.



**Figure 3: Comparative Analysis of the Tax Compliance Obligation Across Various Sectors**

Figure 3 provides a representation of the tax compliance burden across five different industries: Manufacturing, Retail, Service, Technology, and Healthcare. As before, the x-axis captures time or observation periods, and the y-axis captures the compliance burden for each industry. The different industries are represented in different colours and markers, which illustrate the difference in compliance burden at different time points or observations. More specifically, Manufacturing and Retail have the highest compliance burden fluctuations, which can be attributed to the complexity of the regulations governing those industries. In contrast, Service and Technology have lower compliance burdens, presumably due to the fewer physical goods and less complex supply chains. This evidence suggests that the nature of business operations in an industry, and the corresponding tax regulations, are important determinants of tax compliance burdens.



**Figure 4: Tax Compliance Costs and Benefits for SMEs – A Comparison Over Time**

Figure 4 compares the horizontal axis, which is segmented based on distinct durations and corresponding instances, as it analyzes both the tax compliance costs and tax compliance benefits for SMEs for various spans of time. The red line corresponds to tax compliance costs, and the blue line to tax compliance benefits. It is evident that both variables are denominated in USD. It enables the understanding of the monetary interaction and compliance with the equilibrium condition for Small and Medium Enterprises (SMEs). It is clear from the graph that the costs and benefits of tax compliance change in response to time, suggesting certain behaviours and relationships along the timeline of tax compliance.

#### 4.3 Impact on Business Performance and Industry Comparison

This research also gauges the effects of tax compliance burden on businesses across various industries and their overall operating performance. The research outcomes, however, indicate the extent of tax compliance burden on the profitability and the overall growth of the SMEs. The most prominent of such effects would be the decrease in profitability and growth. The SMEs fail to invest adequately in critical aspects of the functioning of the firm, and spend inadequate attention to managing the tax compliance burden allocated to the firm. The limited capabilities hamper the innovative potential of the firm and, in turn, restrict the growth opportunities of the organization. This study also points out the tax compliance burden gap by industry sector. The 'compliance burden' is higher in the manufacturing and retail industry (compliance burden is higher due to the tax system – VAT, excise tax, and other compliance burdens) and lower in services (Service compliance burden deals with payroll tax and employment tax, added to the operating cost). Smaller businesses, and especially SMEs, are the most disadvantaged in terms of the burdensome heavy tax compliance workload. These businesses are under-resourced and under-structured in terms of the necessary tax compliance workload.

**Table 2: Numerical Impact of Tax Compliance Burden on SMEs Across Key Dimensions**

Aspect	% SMEs Affected	Avg. Hours/Month	% Annual Budget Used	% Profit Loss	% Compliance Risk	% Reporting Delays
Profitability & Growth	68	25	12	12	55	48
Resource Allocation	72	30	20	10	50	52
Manufacturing & Retail	80	35	18	15	60	58
Services	55	20	10	8	45	42
Smaller SMEs	77	40	22	18	62	60
Barriers	70	28	15	11	68	54

Table 2 illustrates the tax compliance burden on SMEs through resource allocation, Penalties' effect on profitability, operational risk, industry-specific pressures, and the burden on profitability. The resource allocation ratio details the compliance cost and operational risk of the SME sector and the range of risk for particular industries. All these aspects are translated into the percentages of SMEs affected, compliance

time in average hours per month, percentage of the annual budget, profit compliance loss, compliance risk, and risk. The data illustrates that the manufacturing and retail sector of SMEs is the most burdened, where 80% of the SMEs are affected, and on average, 35 hours are spent per month, while the resource burdened SMEs are 40 hours per month, and 22% of the annual budget is spent on compliance. The compliance burdens these SMEs endure relate to profitability, where SME report 8-18% profit losses, higher compliance risk, where 45-68% admit they are compliant, and significant delays from 42-60% are reported. All these factors constrain the growth and sustainability of SMEs.

The outcomes of this reform regarding increasing the effectiveness and streamlining the operational context of the compliance of SMEs with the tax obligations minimize the sectoral compliance costs and optimize the tax administration. Integration and collaboration with formal structures and frameworks could facilitate faster and better-embraced understanding of the policies in practice and workflows.

The Association of Consultants and Corporate Trainers (ACCT) has determined that the level of regulatory compliance dynamically determines the scope of growth for SMEs and operates as a suppressor for the investment of resources towards innovation, diversification of business, and the development of human resources. Assessment of profits reveals that apart from the direct taxation of SMEs, the business incurs substantial opportunity costs, hidden expenditures of the so-called overheads such as consultancy payments, the business of redundant delays, inopportune resources, realigned focus, etc., which cumulatively dilute the margin, and thin, constrain, and restrain the rate of reinvestment. Taxation must be reasonable because enough will be left for the accumulation of revenues for the public Treasury. The convoluted and rigid nature of the processes that must be complied with must constrain, even suppress, the competitive nature of the business's scalability, growth, and the long-term sustenance of viability in the market, negatively impacting especially small enterprises. There remains a direct correlation between the complexity and digitisation of compliance, and small and medium enterprises (SMEs) that have 70% digitised systems experienced the highest growth rate. This proves the results, which reiterated the anticipated theory that enhancing the tax policies with structural business development policies will alleviate the tax policy and compliance burden, fostering profits within SMEs.

## **6. Conclusion**

Moving further with this paper, presents the various elements within the context of the non-payment noncompliance within the scope of the entire economic breakdown of a country. Added, the non-payment noncompliance regulation seems to be a lesser hindrance to the more economically affluent corporate taxpayers, especially within the context of small and medium enterprises. Compliance-related costs have been shown to include non-value administrative costs relevant to the scope of small/medium enterprises. These are significant costs which, to a degree, can be alleviated through pragmatic approaches toward compliance streamlining, including the provision of frameworks, guides, and targeted subsidized assistance. Collaboration on compliance guides can profitably address administrative burdens and the gaps of inter-regional analytics, the use of borderless compliance frameworks, and the innovation systems. Active policy management on competitively compliant frameworks has the potential to turn economic burdens of non-compliant small/medium enterprises on their head, to pro-value outreach frameworks and employed economic development through job creation. Also, the results confirm that fulfilling the

'challenging scope' for the economic productivity compliance regarding the scope of burden tax is more of a focus and narrowing. The risk is the hidden compliance cost, but also, it is an opportunity that could be captured through the SME assistance frameworks. The passive systems that dominate the SME systems could be replaced with the Protective. These would increase the competitive capacity of the SMEs to embed themselves into transnational value chains, attract financing, and enhance innovation. Therefore, tax policies that are crafted with a responsiveness approach will make the SMEs pivotal to the socio-economic advancement of the country, job creation, and sustainable development.

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