INFLUENCING FACTORS AND IMPROVEMENT PATH OF TAX COMPLIANCE IN CHINESE SMES

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Abstract. The purpose of this paper is to explore the influencing factors and improvement paths of tax compliance in Chinese small and medium-sized enterprises (SMEs). Through semi-structured interviews with the staff of 12 SMEs, this study finds that the failure to establish a tax compliance system, the lack of professional competence of SMEs' tax staff, the failure to use tax incentives correctly, and the complexity of tax laws and regulations are the main obstacles affecting SMEs' tax compliance. Based on the results of the study, this paper puts forward targeted suggestions to improve the tax compliance level of SMEs, with a view to providing references for the government to improve tax policies and SMEs to improve their tax management level.
Keywords: *small and medium-sized enterprises (SMEs), tax compliance, influencing factors, enhancement paths*

Introduction

As an important part of the national economy, the healthy development of small and medium-sized enterprises is crucial to the overall economic vitality (Liu, 2023). Among the existing enterprises in China, small, medium and micro enterprises account for an absolute majority, and their healthy development is crucial to the overall economic vitality. They contribute more than 50% of taxes, provide more than 60% of GDP, produce more than 70% of technological innovation results, and provide more than 80% of employment opportunities for the labor force (Huo, 2024). The Ministry of Industry and Information Technology of China divides enterprises into large, medium, small and micro enterprises according to the industry, number of employees, scale, etc. In practice, enterprises with less than 1,000 employees and more than 300 employees are generally called medium-sized enterprises, and enterprises with between 300 and 30 employees are called small enterprises. Due to the special characteristics of their operation, management, and business, small and medium-sized enterprises face greater competition and survival pressure. Enterprises are often easily affected by the market, third parties, policies, etc., and face more risks, such as economic risks, their own development pressure, industry competition, administrative risks, etc. Small and medium-sized enterprises often lack a complete management system, and the operation of people and property is extremely arbitrary, and the business methods are also quite arbitrary. There are still many challenges in corporate tax compliance. Management loopholes and defects often violate the bottom line of laws or rules, causing great hidden dangers to the development and even survival of enterprises. Exploring the influencing factors and implementation paths of tax compliance of small and medium-

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sized enterprises is of great significance for guiding enterprises to operate in compliance and promoting their sustainable development.

Non-compliance with tax regulations can have serious consequences for SMEs (Vincent et al., 2023; Vincent, 2021), including financial penalties, reputational damage, and legal repercussions. Non-compliance not only affects the business itself, but also has a broader impact on the government's ability to collect taxes and maintain a fair and effective tax system (Nguyen, 2022). Therefore, understanding the factors that affect tax compliance and identifying effective strategies for building a robust tax compliance framework is crucial for China's SMEs. By addressing the two research questions "What factors affect SMEs' tax compliance?" and "How should SMEs build an effective tax compliance construction path?", this study aims to provide Chinese SMEs with practical guidance and suggestions to cope with the complexity of tax compliance and reduce the associated risks. Ultimately, this study aims to contribute to the broader goal of promoting a culture of tax compliance and supporting the sustainable growth and development of Chinese SMEs.

Literature review

Tax compliance is more than just complying with tax laws; it includes risk reduction, regulatory compliance, and fairness of the tax system (Haerani et al., 2023; James and Alley, 2002). Factors influencing compliance include penalties, tax system fairness, tax rates, and audit probabilities (Tilahun, 2019). Tax authorities employ a combination of "soft law" approaches, preventive measures, and incentives to encourage lawful conduct among taxpayers. A risk-based approach to tax control is increasingly relevant, as it allows for efficient allocation of limited resources while promoting compliance. Researchers emphasize the importance of developing strategies that incorporate both economic and behavioral aspects of tax compliance (James and Alley, 2002). Ultimately, fostering a responsible citizen approach and maintaining a fair tax system are crucial for improving tax compliance, rather than relying solely on punitive measures (Tilahun, 2019). In terms of the literature on tax compliance, scholars have conducted extensive research on tax compliance that has carried out extensive research on the influencing factors of tax compliance. These factors can be mainly categorized from the internal factors and external factors of enterprises. The internal perspective involves corporate governance, internal control and other factors. perspective involves corporate governance, internal control, etc., and the external perspective involves social responsibility, auditing, media supervision, etc.

Internal factors of tax compliance. Lin (2023) have found through empirical research that high-quality internal control of enterprises can inhibit aggressive tax avoidance behavior, but Lin et al. (2017) argues that the above view exists only in the case of higher tax control intensity, i.e., the enterprises with high quality of internal control do not have a strong tendency of tax avoidance in the environment of higher tax control intensity, but the lower the tax control intensity, the more firms tend to adopt aggressive tax avoidance behavior. With the improvement of the quality of corporate internal control, the positive relationship between financing constraints and aggressive corporate tax avoidance is significantly weakened (Zhao et al., 2024). The level of corporate governance has a significant inhibitory effect on the tax aggressiveness of private enterprises, but the inhibitory effect on the tax aggressiveness of state-owned enterprises is not significant (Lai et al., 2023). External factors of tax compliance. The study found that media attention can inhibit the degree of corporate tax aggressiveness; and there is a

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substitution effect between the level of corporate governance and media attention on corporate tax aggressiveness. A study found that enterprises involved in more social responsibility have more aggressive tax avoidance behavior, and relative to high-transparency enterprises, low-transparency enterprises' involvement in social social responsibility, the more aggressive their tax avoidance is. Previous study find that auditing, as one of the external governance mechanisms for firms, plays a role in monitoring and resisting corporate tax non-compliance.

Materials and Methods

The research methodology chosen for this study is a qualitative research approach to answer the research question. This approach is particularly suitable for this research question to gain a deeper understanding of the complex factors that affect tax compliance. Boddy (2016) mentioned that 12 samples may be a case of data saturation in a relatively homogeneous group. Therefore, this study adopted a purposive sampling method and selected 12 respondents working in small and medium-sized enterprises for semi-structured interviews. Semi-structured interviews are usually based on an interview guide (Magaldi and Berler, 2020) and the researcher usually has only one opportunity to talk to the respondent. Semi-structured interviews are informal interviews that follow a rough outline. The method has only a rough outline of the conditions of the interviewee, the questions to be asked, and so on, and the interviewer has the flexibility to make the necessary adjustments according to the actual situation at the time of the interview. Semi-structured interviews are interlinked with respondents' expectations, and respondents' views are more likely to be expressed in reasonably well-designed contexts (Flick, 2022), rather than being constrained by standardized templates as is the case with questionnaires.

Participants include attorneys, business executives, corporate compliance officers, and executive branch officials. These individuals were selected because they directly or indirectly dealt with compliance-related legal issues or were decisive in the outcome, and their responses were appropriate for dealing with specific issues. This study utilizes the strategy of Purposive Sampling, which is essentially a non-probability sampling method. Purposive Sampling, also known as directed sampling, is a researcher-defined sampling method in which the main purpose is to achieve the research study with a smaller sample and the subjects selected have some specific purposeful characteristics or qualities, which is to select a small number of subjects from the majority of the public or potential subjects according to a specific set of conditions, in order to achieve more with less. The researcher can analyze the ability of the participants to provide information based on his or her own intellectual judgment and finally select the participants (Niyonzigira, 2023).

Results and Discussion

Causes of tax risks in SMEs

The following *Table 1* has been designed to systematically analyze and categorize the qualitative data collected from respondents regarding tax compliance issues in small and medium-sized enterprises (SMEs). The purpose of this table is to organize the various quotes from respondents into coherent themes and specific codes, allowing for a

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more structured understanding of the key challenges faced by SMEs in tax compliance. The table is structured with 3 columns: The 'Theme' column groups similar issues together, providing a high-level view of the main areas of concern in tax compliance for SMEs. The 'Code' column further breaks down each theme into more specific issues or sub-themes, allowing for a more nuanced understanding of the challenges within each broader category. The 'Quote' column provides the exact words of the respondents, offering concrete evidence to support the identified themes and codes. This helps maintain the authenticity of the data and allows for direct reference to the respondents' experiences and opinions.

***Table 1**. Qualitative data coding.*

Theme	Code	Quote
Lack of Expertise and Process	Insufficient tax management structure	"The tax management department of my company only has the finance department, which results in no compliance personnel involved in tax planning, supervision and review." (Respondent 3)
	Reliance on experience rather than expertise	"Some financial personnel in my company only conduct tax declaration activities based on experience and cannot effectively prevent tax risks." (Respondent 7)
Insufficient Professional Ability	Failure to update knowledge	"In my long-term work, I found that some personnel did not seriously study the new tax regulations due to years of mechanized operation, and used the wrong taxable account to calculate taxes." (Respondent 1)
	Lack of business understanding	"The tax personnel in my company are not good at business, and they only obey the orders of the leaders at work, which violates the basic professional ethics of tax personnel." (Respondent 8)
	Lack of responsibility	"The tax personnel in his small and medium-sized enterprise lack a sense of responsibility and make operational errors in the process of handling tax-related matters, resulting in overdue tax declarations and fines for the company." (Respondent 9)
Incorrect Use of Tax Preferential Policies	Risk of underpaying taxes	"My company tends to conduct tax planning to minimize the amount of tax paid. However, during the planning process, if the relevant personnel do not have a good understanding of the tax law, they may not be able to pay the tax in full and on time, and in serious cases, they may be subject to legal sanctions" (Respondent 2)
	Risk of overpaying taxes	"I have heard that my friend's small and medium-sized enterprises have a misunderstanding of tax risks. They think that as long as they pay more taxes, the company will be tax compliant, so they have not studied tax incentives at all, so part of the funds that could have been used for production and operation have become taxes." (Respondent 4)
Complexity of Tax Law and Regulation System	Difficulty in understanding	"Faced with a complex tax law system, it is easy to have misunderstandings when understanding some laws and regulations." (Respondent 5)
	Poor practicality of regulations	"In practice, some laws and regulations are poorly practical, which increases the difficulty of corporate tax payment." (Respondent 6)
	Frequent policy changes	"Tax policies and implementation details are constantly changing. Faced with such changes, enterprises are more likely to make misunderstandings and omissions, thus engaging in non-compliant behaviors." (Respondent 10)

Lack of expertise and process

If an enterprise fails to establish a tax compliance system, it will lead to tax risks at the source. Under the premise of risk control, the internal control system of most enterprises is mainly about the authenticity of accounting information. For this purpose, internal audit and external audit processes are designed. However, in this audit process, the management of tax-related matters is often missing. Respondent 3 mentioned: "The tax management department of my company only has the finance department, which results in no compliance personnel involved in tax planning, supervision and review." Respondent 7 mentioned: "Some financial personnel in my company only conduct tax declaration activities based on experience and cannot effectively prevent tax risks."

Insufficient professional ability

Tax personnel in SMEs are generally professionally trained and have a certain degree of education, but they still lack the ability to match the analysis of regulations with the company's own business, resulting in failure to strictly abide by the regulations when paying taxes, resulting in non-compliant tax payment. Respondent 1 mentioned: "In my long-term work, I found that some personnel did not seriously study the new tax regulations due to years of mechanized operation and used the wrong taxable account to calculate taxes." In addition, Respondent 8 mentioned: "The tax personnel in my company are not good at business, and they only obey the orders of the leaders at work, which violates the basic professional ethics of tax personnel." Respondent 9 mentioned: "The tax personnel in his small and medium-sized enterprise lack a sense of responsibility and make operational errors in the process of handling tax-related matters, resulting in overdue tax declarations and fines for the company."

Incorrect use of tax preferential policies

Tax compliance of SMEs mainly helps enterprises solve two risks: one is the risk of underpaying taxes. Respondent 2 mentioned: "My company tends to conduct tax planning to minimize the amount of tax paid. However, during the planning process, if the relevant personnel do not have a good understanding of the tax law, they may not be able to pay the tax in full and on time, and in serious cases, they may be subject to legal sanctions; another is the risk of overpaying taxes. Insufficient understanding of tax laws may also lead to the company not making full use of tax incentives when paying taxes, resulting in additional financial losses." Respondent 4 said: "I have heard that my friend's small and medium-sized enterprises have a misunderstanding of tax risks. They think that as long as they pay more taxes, the company will be tax compliant, so they have not studied tax incentives at all, so part of the funds that could have been used for production and operation have become taxes."

Complexity of tax law and regulations system

China's current tax law and regulation system is complicated. The tax laws involved in enterprises include the "Stamp Tax Law of the People's Republic of China", "Deed Tax Law of the People's Republic of China", "Urban Maintenance and Construction Tax Law of the People's Republic of China", "Resource Tax Law of the People's Republic of China", "Vehicle and Vessel Tax Law of the People's Republic of China", "Enterprise Income Tax Law of the People's Republic of China", etc. In addition, there are administrative regulations, local regulations, departmental regulations, and regulations. Respondent 5 said, I also graduated from a regular financial school. Faced with a complex tax law system, it is easy to have misunderstandings when understanding some laws and regulations. Respondent 6 also mentioned that in practice, some laws and regulations are poorly practical, which increases the difficulty of corporate tax payment. Respondent 10 said that in recent years, the central government has comprehensively implemented tax reforms, from business tax to value-added tax to tax reduction and fee reduction, and the merger of national and local taxes. Tax policies and implementation details are constantly changing. Faced with such changes, enterprises are more likely to make misunderstandings and omissions, thus engaging in non-compliant behaviors.

Tax compliance management improvement path of SMEs

Enterprise tax compliance self-assessment

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To ensure the tax compliance of enterprises, enterprises should analyze their tax compliance status. However, for enterprises that have never carried out compliance management, it is a headache to know where to start. Therefore, we have set up a corporate tax compliance self-assessment form to help enterprises take the first step in tax compliance. Enterprises can make a preliminary assessment of the tax compliance of enterprises according to the contents in the form. If more than 20% of the contents are negative, the enterprise should determine that it has tax compliance risks and attach importance to the construction of the tax compliance system. This approach is similar to the tax risk assessment promoted by the U.S. Internal Revenue Service (IRS), which is designed to help companies proactively identify and manage tax risks (Neuman and Sheu, 2022). It helps SMEs proactively identify potential tax compliance risks and lays the foundation for the subsequent establishment of a tax compliance system.

Establish a tax compliance management department

At present, the tax issues of many companies are mainly controlled by finance. If the size of the enterprise is small, this control can still play a certain role. However, if the size of the enterprise is large, the business types are more, and the sales volume is also large, the complexity of the enterprise's tax-related issues is not something that finance can control. At this time, the company should consider setting up a tax compliance management department to connect with finance and help the enterprise better handle tax compliance management. The tax compliance management department may set up a tax compliance supervisor, a comprehensive tax compliance specialist, a tax invoice and voucher management specialist, a contract compliance management specialist (tax direction), a personal income tax compliance management specialist, etc. In addition to reviewing their own business every day, each specialist shall cross-check the business of others at the beginning of each month and submit a tax compliance report in the middle of each month, which shall be reviewed by the tax compliance supervisor and the tax compliance issues found should be reported to the company's board of directors in a timely manner. When setting up tax compliance departments and positions, enterprises should pay attention to the following: the establishment should be guided by the goals of the company's tax compliance management, and the positions should be configured and the job responsibilities should be determined in conjunction with the goals; the relevant positions of tax compliance management should be separated, restricted and supervised from each other, and a rotation mechanism and an interactive inspection mechanism should be set up; the relevant positions of tax compliance management should be tested for their professional qualifications at the time of recruitment to ensure the smooth progress of compliance management, and personnel with good professional ethics should be selected.

Establish the responsibilities of the tax compliance management department

Based on the above-mentioned job setting of the tax compliance management department, its departmental responsibilities should include but are not limited to the following points: (1) Provide tax compliance management reference for major corporate decisions: When the company makes major business plans and decision-making, give professional opinions to ensure that the tax-related issues in the company's plans and decisions comply with the requirements of domestic and foreign laws and regulations; and calculate the tax burden of related projects, and give tax saving strategies and

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suggestions based on the company's tax risk preference; (2) Training on tax-related information: The department is responsible for collecting and studying tax laws, regulations, policies, etc. related to the company, and organizing personnel from various departments of the company to participate in relevant training in turn, so that personnel from various departments can learn the latest information on tax compliance at the first time and form tax compliance for all employees; (3) Supervise the company's daily tax-related business: Draft the implementation details of the company's tax compliance; formulate the company's tax planning plan for the next year at the end of the year and supervise the specific implementation of each department within the plan; review whether the tax-related links in the company's contract signing are compliant; monitor the company's daily tax payment to ensure tax compliance; be responsible for tax declaration and supervise the tax payment of the financial department; be responsible for applying for tax incentives; (4) Dealing with tax authorities on tax-related issues: Assisting tax authorities in conducting various investigations on enterprises and responding to their inquiries; handling tax administrative reconsideration applications and administrative litigation and other related matters.

Improving the compliance management system for invoices and vouchers

Strengthening the daily management of invoices and vouchers

Enterprise tax specialists receive invoices from the tax department, and then hand over the invoices received to the invoice and voucher management post for safekeeping. The relevant original vouchers, invoice copies, etc. should be sent to the finance department for accounting as soon as possible. After issuing the invoice, the invoice stumbling should be properly reported, and an invoice registration book should be established. Enterprises should choose a fixed time each month according to their own situation, and the invoice and voucher management staff and the comprehensive tax compliance specialists should take inventory of the invoices, record the inventory, and sign for confirmation.

Strictly review the compliance of invoice issuance

The invoice and voucher management specialist should communicate with the other party's company about the invoice information before the invoice is issued, including but not limited to the quantity, unit price, amount, and information in the remarks column of the goods sold, to avoid errors. After the communication is completed, the financial staff will issue the invoice, and the invoice and voucher management specialist will sign to confirm its compliance.

Timely record external invoices

In the course of business transactions, the company will have a large number of external invoices that need to be recorded. Each business department should require the other party to issue formal invoices while generating external business. After obtaining the invoice, the staff responsible for docking business should promptly check the various information recorded on the invoice to ensure that it is correct, and then hand it over to the department head for signature, and then hand it over to the tax compliance manager to confirm the legality and compliance of the invoice, and log in to the tax department's invoice management platform to verify the authenticity of the invoice. If

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the invoice still has deduction items, the tax compliance manager can hand it over to the financial staff for accounting.

Be cautious in tax planning

Tax planning cannot simply be to hire an external company and have them make a tax planning plan for the company to implement. Instead, companies need to first have an in-depth understanding of tax policies and regulations and combine their own business operations and tax status to adapt to local conditions in order to avoid legal and policy risks in planning. On the premise that the company has established a corporate tax compliance department, tax compliance managers should first identify the company's operating conditions and target needs and combine relevant tax preferential policies to tailor a tax saving plan that best meets the company's needs. Tax planning is a work planned before tax payment, so when the actual business is carried out, it may be encountered that the initial plan cannot be implemented, and the relevant reference policies and regulations have changed. This requires tax compliance personnel to follow up in a timely manner, dynamically manage the content of tax planning, and flexibly and maneuverably promote the completion of the company's tax saving plan.

Conclusion

The causes of tax compliance risk of SMEs are mainly that SMEs have not established internal tax compliance system, SMEs' tax personnel have insufficient professional ability, tax incentives are not used correctly, and tax laws and regulations are complicated. Improving the tax compliance management mechanism, perfecting the invoice and voucher compliance management system, and prudent tax planning can help improve the tax compliance effect of SMEs and promote the sustainable development of enterprises. SMEs should recognize the importance of tax compliance in order to build a more robust and sustainable business model, which will help them achieve long-term development. This research contributes to both academia and industry by addressing a gap in the existing literature and practice regarding tax compliance in Chinese SMEs. To date, limited research has focused specifically on the unique challenges and opportunities faced by SMEs in navigating the complex Chinese tax landscape. This study provides valuable insights into the key factors influencing tax compliance within this vital sector of the economy. Furthermore, the proposed implementation path offers practical guidance for SMEs seeking to enhance their tax compliance efforts. This research is therefore expected to be of significant interest to academics seeking to further explore the complexities of SME tax compliance and to industry practitioners seeking to improve their own organizations' compliance practices. By shedding light on this under-researched area, this study contributes to the development of a more robust and comprehensive understanding of tax compliance in the context of Chinese SMEs.

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Conflict of interest

The authors confirm that there is no conflict of interest involve with any parties in this research study.

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