

# Tax Compliance: Taxpayers' View (Perception)

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## **Abstract**

**Purpose:** The purposes of this study is to determine the level of tax compliance, the perception on tax compliance in terms of demographic factors, and assess the factors (tax fairness, tax knowledge, and tax complexity) influencing tax compliance among taxpayers in Malaysia among individual taxpayers in Malaysia. Tax is a compulsory contribution to government revenue in order to fund the infrastructure costs which are needed for the delivery of public services to individual states and the country collectively. However, individuals may decide not to pay tax due to different reasons. In addition, there have been so many cases publicized by the media on taxpayers who avoid paying taxes.

**Design/methodology/approach:** The test of differences is performed to evaluate the demographic factors with the perception on tax compliance decision. Meanwhile, the correlation analysis is performed to study the relationship between independent variables with the taxpayers' perception towards tax compliance

**Findings:** The results found that there is a positive relationship between tax fairness and tax knowledge towards perception on tax compliance. In the other hand, tax complexity is negatively related to the perception on tax compliance.

**Research limitations/implications:** A survey has been conducted by which questionnaires were only distributed to taxpayers in Selangor and Putrajaya. Only three factors (tax fairness, tax knowledge and tax complexity) used to indicate the reasons for tax compliance decision among taxpayers in Malaysia.

**Practical implications:** Contribution to the policy maker to improve tax governance which promotes accountability and transparency in managing the tax fund. The government can educate the citizens through a series of campaign and advertisement to give exposure and enhancing tax knowledge among citizens.

**Originality/value:** This study contributes especially to understand the perception of taxpayers' decision for compliance as well as increase awareness among individuals in Malaysia regarding the importance of complying with tax regulations.

**Keywords:** tax compliance, demographic factors, tax fairness, tax knowledge, tax complexity

## **Introduction**

Since tax is the main revenue of the country, government needs the citizens to adhere with the tax rules and fulfilling tax compliance. Tax compliance has always been a major issue for governments worldwide and a number of opportunities are available for taxpayers to evade taxes. Malaysia is one of the countries that have not achieve the target on tax collection based

on gross domestic product. Despite having a working population of nearly 15 million people, only 6.9 million filed their tax returns in 2016, of which, only 2.27 million individuals actually paid taxes after tax incentives (Kana, 2018). The consequences of these taxpayers' behaviour give an extra cost to government as they need to initiate another effort to get what is supposed to be theirs. This additional cost incurred will eventually set off the revenue gain by government.

The failure to comply with tax will results in damaging the taxpayers' reputation with the authorities and the public. Thus, they will not only faces financial risk such as financial penalties and tax charges but they will also need to face serious business risk. With the advancement of technology, declaration of income has become more convenient with the introduction of electronic filing (e-filing) system. It is the process of submitting tax returns over the internet by using a tax preparation software that has been pre-approved by Inland Revenue Board (IRB). Therefore, there should be no issue arise on non-tax compliance as the action can be done at their fingertips only.

Additionally, Tan (2016) also highlighted, the individuals that IRB aimed is the professional workers consist of lawyers, doctors, engineers and other professional workers which can be said as having an intellectual mind and good attitudes. Furthermore, despite the introduction of tax facilitation measures such as assistant in tax filing, taxpayers' behaviour remained largely unchanged (Cyan et al. 2016).

Some of the empirical studies have shown that tax knowledge has influenced the level of tax compliance by individual taxpayers (Cyan et al. 2016 and Chan et al. 2017). Besides, tax fairness has also become one of the factors affecting the level of tax compliance (Chan et al., 2017 and Musimenta et al. 2017). These studies shown that there is relationship between tax fairness and tax knowledge with tax compliance decision. However, lack of studies on these determinants has been done among the individual taxpayers in Malaysia. Other than that, a further and in depth study needs to be conducted to figure out the factors affecting the tax compliance by individual taxpayers in Malaysia.

This study provides benefits to the taxpayers by indirectly creating awareness regarding their responsibility to declare income. Taxpayers will realize that need to declare their income and only need to pay tax when they have reach the minimum taxable income. In addition this study gives contribution to the policy maker which is IRB itself where they can improve tax governance which promotes accountability and transparency in managing the tax fund. Moreover, government also can educate the citizens through a series of campaign and advertisement to give exposure and enhancing tax knowledge among citizens

## **Literature Review**

### ***Demographic factors***

#### ***1. Age***

Previous researchers suggested that the older taxpayers are more likely to comply with tax rules and regulations than younger taxpayers (Alabede, 2014, Witte & Woodbury, 1985 & Dubin & Wilde, 1988). The higher the age, the need for public goods such as social security and health care also increases. Older citizens might, thus, treasure the benefits of taxes more than younger ones and be more compliant. They also might be in a better financial situation than younger ones. Thus, it is easier for them to afford being tax compliant due to fewer budget constraints (Hofmann et al., 2017). On the contrary, the evidence in the study of Clotfelter (1983) and Gupta (2009) indicated that age has no effect on taxpayers' attitude toward tax evasion.

## **2. Gender**

Mixed results regarding gender have been found from previous studies. Some studies have shown males to be more compliant than females while the others stated otherwise. According to Mohamad et al. (2017), males are said to be consistently more likely to accumulate tax arrears. This is supported by Torgler & Valev (2010) which suggested that women are more likely to be opposed to tax evasion than men, suggesting that women are more compliant. Another study by Kasipillai & Abdul-Jabbar (2006) found that there was no significant difference between male and female attitudes towards tax evasion and non-compliance. In addition, Torgler et al. (2008) stated that gender differences could be attributed to different biological, psychological and experiential realities that lead to different approaches to issues and problems.

## **3. Education background**

Education refers to the level of qualification hold by individuals. A low level of education may be related to low tax compliance (Bobek et al., 2007). By contrast, a study by Hoffman et al. (2017) found that a rather small but significant relation between education level of taxpayers and their tax compliance. Higher educated respondents tend to comply less with tax law compared to individuals who are less educated. An empirical study by Borrego et al. (2017) illustrated that the tax professionals claimed they would peremptorily refuse to participate in intentional tax non-compliance due to sense of personal and professional ethics, their tax morality and their need to preserve their professional reputation.

## **4. Income level**

Individuals who earned income are required to declare their income to the IRB and if eligible, they have to pay taxes. Study by Hofmann et al. (2017) stated that low-income earners are hypothesized to be less tax compliance, meanwhile, it is assumed that high-income earners are more likely to evade taxes. The study by Jaffar-Harun et al. (2014) also support that low income earners are less compliant compared to higher income earners. According to the study, it is because most of the low-income earners may not yet qualified to pay tax. In addition, Gadi (2015) suggested that there is high tax compliance for each unit increases in income. Hamm (1995) implied that low income level will increases tax compliance decision.

### ***Dependent variable***

#### ***Tax compliance decision***

Isa (2014) indicated that tax compliance has always been an area of concern to policy makers, tax administrators and society in general. This is because tax is the main source of government revenue which will be used to provide benefits to the society. According to James & Alley (2002), tax compliance refers to the willingness of individuals to act in accordance to the tax laws and administration without the application of enforcement activity. Tax compliance also can be referred to payment compliance, filling compliance and reporting compliance (Brown & Mazur, 2003). Yusoff & Mohd (2017) stated that the major areas of non-compliance in Malaysia include tax avoidance and tax evasion. Tax avoidance is defined as legal measures to use the tax regime to find ways to pay the lowest rate of tax, for instance putting savings in the name of your partner to take advantage of their lower tax band, setting up residence in a country with low-income tax rates and putting assets in your spouse's name so he/she can pay a lower rate of income tax. Meanwhile tax evasion is taking illegal steps to avoid paying tax, for example not declaring/hiding income to the tax authority, over claiming expenses or declaring bankruptcy and restarting company under a different name ([www.economicshelp.org](http://www.economicshelp.org))

In recent years, there have been efforts to better understand factors that influence individuals' perceptions. Individuals refer to those who are responsible to declare their income tax. They include actual and potential taxpayers who received income through earning wages by working and/or operating businesses. To simplify, they are referred as taxpayers in further discussion. Better understanding of taxpayers' motives, attitude and choices would significantly improve voluntary compliance (Walsh, 2012; OECD, 2010). The decision of tax compliance depends on the declaration of taxpayers' main income sources. It has become taxpayers' norms to report their income as low as possible to minimize their tax payables. When income has been declared, another issue arises as to whether the taxpayers want to pay the taxes as what has been charged to them.

### ***Independent variables***

#### ***1. Tax fairness***

Tax fairness refers to a system that aims to create a system of taxation that is fair and transparent for all taxpayers. According to a study by Chan et al. (2017), it is acceptable for the taxpayers to pay taxes when they determine that the tax system is fair by distributed the proportion of tax rates fairly between higher income and lower income earner. Taxpayers also demand a fair treatment of tax system for them to be satisfied and willingly to pay to the government (Chan et al., 2017). As indicated by Nkundabanyanga et al. (2017), taxpayers believed a fair government is the one that safeguards their interests and consequently, tax morale increases and tax evasion decreases. A study by Faizal et al. (2017) also indicated that tax fairness will result in a higher tax compliance decision as taxpayers is satisfied with the tax system. By contrast, the perceptions of tax fairness may not be the same in a different jurisdiction. By contrast, a study by Gilligan & Richardson (2005), there was no relationship that exists cross culturally between the different facets of tax fairness perceptions and tax compliance behavior.

#### ***2. Tax knowledge***

The understanding of taxpayers' on tax policy concept and other tax-related information is known as tax knowledge. According to Mat-Udin (2015), knowledge such as tax liability computation and information on tax relief are considered as an important aspects that enable the taxpayers to compute their own tax liability. According to Tusubira & Nkote (2013), the study asserted that tax knowledge and tax compliance are positively related. On top of that, a study by Loo et al. (2009) that conducted in Malaysia also suggested tax knowledge to be the most influential factor in determining taxpayers' compliance behaviour under self-assessment system which implies that greater tax knowledge leads to higher compliance rates. The finding from Chan et al. (2017) and Palil (2010) demonstrated that tax knowledge has significant positive relationship with tax compliance and it indicates that tax knowledge should be improved to discipline the taxpayers' in Malaysia. Besides, the study of Loo & Ho (2005) implied that the lack of tax knowledge may lead to non-compliance behaviour of taxpayers. In this study, the individual taxpayers have relatively low knowledge and not familiar to exercise appropriate compliance using self-assessment system. Meanwhile, similar study by Fauziati et al. (2016) conducted in Indonesia, found that tax knowledge has no significant impact on tax compliance.

#### ***3. Tax complexity***

The self-assessment system (SAS) has been widely practiced all around the world. Under this system, one issue that has been highlighted is the non-compliance behaviour. In Malaysia, the SAS has been implemented for more than a decade. The taxpayers are compulsorily declare and calculate accurate source of income, estimate income payable, keep records for audit

purposes and understand other income tax legislations. These conditions exposed the taxpayers with difficulties in complying with tax obligations under the SAS (Saad, 2014). In addition, previous study by Isa (2014) concluded that tax auditors identified tax complexity as one of the major compliance variables among corporate taxpayers. This study found that the issue of tax complexity, particularly tax computation, record keeping and tax ambiguity is still relevant in Malaysia, thus may negatively affected the level of tax compliance among Malaysians. A study by Saad (2014) concluded that complexity of the income tax system compelled taxpayers to not comply, either intentionally or unintentionally. A research by Gambo et al. (2014) found that there is significant negative correlation between tax complexity and tax compliance in Africa. Richardson (2006) found that lower tax complexity resulted in lower tax evasion. In the study by Borrego et al. (2017) found the certified accountants admitted to a relationship between tax complexity and their unintentional tax non-compliant behaviour.

## **Hypothesis Development**

### ***Demographic factors***

The findings from Witte & Woodbury (1985), Dubin & Wilde (1988), Alabede (2014) and Hoffman et al. (2017) indicated that there is differences in the compliance level between young taxpayers and older taxpayers. However, mixed results have been found. For instance, Mohamad et al. (2017) and Torgler & Valev (2010) suggested that women are more tax compliant than men. In addition, people with a good education background is said to be more tax compliant (Richardson, 2006; Bobek et al., 2007; Borrego et al., 2017). In relation with income level, a few studies from Hofmann et al. (2017), Jaffar-Harun et al. (2014) and Gadi (2015) stated that low income earners tend to be less compliant compared to high income earners. For these factors, the following hypotheses have been developed:

*H1a: Individuals from different age level have different perception towards tax compliance.*

*H1b: Individuals from different gender have different perception towards tax compliance.*

*H1c: Individuals from different education background have different perception towards tax compliance.*

*H1d: Individuals from different income level have different perception towards tax compliance.*

### ***Tax fairness***

According to Chan et al. (2017), Nkundabanyanga et al. (2017) and Faizal et al. (2017), the level of tax compliance will be high if the taxpayers think that the tax system is fair towards them. Thus, the second hypothesis is:

*H2: There is a relationship between tax fairness and taxpayers' perceptions towards tax compliance.*

### ***Tax knowledge***

The findings from Tusubira & Nkote (2013), Chan et al. (2017), Palil (2010), and Loo & Ho (2005) indicated that the taxpayers become more compliance when they perceived more tax knowledge. Therefore, it is expected that tax knowledge has significant relationship with tax compliance. The third hypothesis is:

*H3: There is a relationship between tax knowledge and taxpayers' perceptions towards tax compliance.*

### ***Tax complexity***

Isa (2014) and Saad (2014) concluded tax complexity does give effect to tax compliance in Malaysia. Meanwhile, research by Gambo et al. (2014) clearly stated that tax complexity is negatively relative to tax compliance. Richardson (2006) stated that lower tax complexity leads to lower tax evasion. Research by Borrego et al. (2017) concluded that tax professionals admitted there is relationship between tax complexity and tax non-compliant behavior. The last hypothesis is:

*H4: There is a relationship between tax complexity and taxpayers' perceptions towards tax compliance.*

### **Method**

#### ***Population and sample***

For this study, the population is the taxpayers who work Selangor and Putrajaya, Malaysia. As at July 2020, there are about 15.82 million of employed person under Malaysia Labour Force (Department of Statistics Malaysia (DOSM), 2020).



Figure 1: Malaysian Labour Force

As for Selangor and Putrajaya, there are a total of 3.592 million people employed (DOSM, 2020) with private/private sectors including sole proprietors where some of them are not even registered under Company Commission Malaysia. Therefore, there is a high tendency for these employees to not declare their income to IRB. The average income in Putrajaya and Selangor are RM9,983 and RM8,210 respectively (DOSM, 2020). In regards to this study, the participants selected as sample are those who work in Selangor and Putrajaya only.

#### ***Data collection procedures***

The method that will be used to collect data is questionnaire which is adapted from Gilligan & Richardson (2005), Palil (2010), Alabede (2014), Isa (2014), Saad (2014), Chan et al. (2017) and Mohamad et al. (2017). The questionnaires distributed through two ways, personally administered questionnaire and electronic questionnaire (Google Forms). The reasons for choosing this method are because it will ensure full and truth response as the anonymity is high, thus they will not hesitate to answer any question related to sensitive issues. In addition, electronic questionnaire will increase the reachable respondents as this method can cover any geographical area that does not being visited. Besides, the electronic questionnaire also save budget because the distribution is done by using internet as the medium to communicate with the respondents (Sekaran & Bougie, 2016).

### **Statistical analysis**

This study uses three types of variables which are demographic variables, dependant variable and independent variables. As for demographic variables, it involved age, gender, education and income using nominal & ordinal scale. The independent variables for this study are tax fairness, tax knowledge and tax complexities using interval scale with a five point Likert Scale. The data gathered from the questionnaire, it examined with the Statistical Package for Social Science (SPSS) version 29 for descriptive analysis, normality analysis, reliability analysis, and test of differences (Sekaran & Bougie, 2016 & Salam et al., 2018)

### **Findings**

In relation with the following analysis, a total of 290 responses have been successfully collected. Thus, further discussion of these analyses will be based on the data collected.

### **Normality test**

Table 1 presents the result from the Kolmogorov-Smirnov Test. As a result, the table shows that the dependent variable “Compliance” has a significant value of 0.000 which is less than 0.05 thus indicates that it was not normally distributed. Other than that, variables for “Fairness”, “Knowledge” and “Complexity” also exhibit the significant values of less than 0.05 where the data significantly deviate from a normal distribution. Therefore, non-parametric test is conducted for further analysis.

Table 1: Normality Analysis

	Kolmogorov-Smirnov		
	Statistic	df	Sig.
Tax compliance	0.093	290	0.000
Tax fairness	0.089	290	0.000
Tax knowledge	0.080	290	0.000
Tax complexity	0.103	290	0.000

### **Reliability test**

As shown on Table 2, the Cronbach’s Alpha is 0.783 which signify that the 45 questions for the variables of tax compliance, tax fairness, tax knowledge and tax complexity are reliable and has a high level of internal consistency. The Cronbach’s Alpha for the tax compliance and tax fairness is 0.845 and 0.765 respectively showing that the result of positive correlated and this findings exhibit that internal consistency of the data is significantly high. Meanwhile the Cronbach’s Alpha for the tax knowledge and tax complexity is 0.679 and 0.623 respectively, which can be considered to be reliable (p-value > 0.60).

Table 2: Reliability Analysis

	Cronbach’s Alpha	N of items
All factors	0.783	45
Tax compliance	0.845	18
Tax fairness	0.765	7
Tax knowledge	0.679	8
Tax complexity	0.623	12

## Descriptive analysis

### *Demographic profile*

Most of the respondents are individuals below the age of 26 years old at 37.9% (n=110) with the majority of the respondents are female with percentage of 70% (n=203). In terms of education background, most of the respondent have diploma or certificate qualification which represent 40.3% (n=116) and for income level, 71.7% (n=208) of the respondent have an income level below RM 3,001 which represent most of the population.

Table 3: Demographic Profile for Respondents

Demographic profiles	Items	Number of respondents	Percentage
Age	<b>Below 26 years old</b>	<b>110</b>	<b>37.9</b>
	26 – 35 years old	109	37.6
	36 – 45 years old	45	15.5
	Above 45 years old	26	9.0
Gender	Male	87	30.0
	<b>Female</b>	<b>203</b>	<b>70.0</b>
Education Background	No Formal Education	4	1.4
	Primary School	1	0.3
	Secondary School	64	22.1
	<b>Diploma or Certificate</b>	<b>116</b>	<b>40.3</b>
	Degree	85	29.3
	Postgraduate	9	3.1
	Professional	10	3.4
Income Level	<b>Below RM3,001</b>	<b>208</b>	<b>71.7</b>
	RM3,001 – RM4,500	30	10.3
	RM4,501 – RM6,000	22	7.6
	Above RM6,000	30	10.3

### *Tax compliance*

The highest mean lies on question 5 at 3.64 and standard deviation of 0.91 - *When I pay tax, I do so to support the country and other citizens*'. It reveals that, people pay tax because they want to support the government and at the same time, they want to help other citizens. The level of tax compliance in Malaysia is at an average level (3.02) which means the tax compliance level is not high but at the same time not too low (moderate).

### **Test of differences**

#### *Age, Education background & Income Level*

Kruskal Wallis test indicates whether different age of taxpayers will give an effect to the perception on tax compliance. Based on Table 4, difference between age and tax compliance have a p-value of 0.277. The p-value is higher than 0.05 thus, it shows that there is no significant difference between age and tax compliance. This result is in contrast with the study from Witte and Woodbury (1985), Dubin and Wilde (1988), Alabede (2014) and Hoffman et al. (2017). Therefore, **H1a** cannot be supported.

Kruskal Wallis test indicates whether different education level of taxpayers will give an effect to the perception on tax compliance. Based on table 4, difference between education and tax compliance has a p-value of 0.600. The p-value is higher than 0.05 showing that there is no significant difference between education and tax compliance. The finding contradict with the

study from Richardson (2006), Bobek et al. (2007) and Borrego et al. (2017) Therefore, **H1c** hypothesis cannot be supported.

Meanwhile result for income level indicates that different level of income has different tax compliance. Income has a p-value of 0.002 which is significant as it is less than 0.05. This means that there is significant difference between income and tax compliance. The result is supported by Hoffman et al. (2017), Jaffar-Harun et al. (2014) and Gadi (2015). Thus, **H1d** hypothesis can be supported.

Table 4: Age, Education Background & Income Level (Kruskal Wallis Test)

	Tax compliance (Sig)
Age	0.277
Education background	0.600
<b>Income Level</b>	<b>0.002</b>

### Gender

This test indicates whether different gender of taxpayers will give an effect to the perception on tax compliance. Based on Table 5, difference between gender and tax compliance have a p-value of 0.965. The p-value is higher than 0.05 thus, it shows that there is no significant difference between gender and tax compliance. This finding is contrast with study from Mohamad et al. (2017) and Torgler & Valev (2010). Therefore, **H1b** cannot be supported.

Table 5: Gender (Mann-Whitney Test)

	Tax compliance
Asymp. Sig.	0.965

### Spearman correlation

Table 6, the correlation coefficient for tax compliance and tax fairness is 19.2% with s-value of 0.000. It shows that there is positive relationship between tax fairness and tax compliance. The higher the tax fairness, the higher the tax compliance. It shows that the relationship between tax fairness and tax compliance is very significant. This results in line with previous study by Chan et al. (2017), Nkundabayanga et al. (2017) and Faizal et al. (2017), where the tax compliance is high when the treatment of tax system is fair. Therefore, **H2** hypothesis is supported.

The correlation coefficient for tax compliance and tax knowledge is 23.5% with s-value of 0.000. It shows that there is positive relationship between tax knowledge and tax compliance. The higher the tax knowledge, the higher the tax compliance. It shows that the relationship between tax knowledge and tax compliance is very significant. Previous study by Tusubira & Nkote (2013), Chan et al. (2017), Palil (2010), and Loo & Ho (2005), also demonstrate that tax knowledge has significant positive relationship with tax compliance and suggest to improve tax knowledge in order to have a discipline taxpayers in Malaysia. Therefore, **H3** hypothesis is supported.

The correlation coefficient for tax compliance and tax complexity is -19.4% with s-value of 0.001. It shows that there is negative relationship between tax complexity and tax compliance. The higher the tax complexity, the lower the tax compliance. This in line with the results by studies from Saad (2014) and Richardson (2006). In their study, tax compliance is low in countries with a complex tax system. Thus, **H4** hypothesis is supported.

Table 6: Spearman Correlation Analysis

Correlation (Spearman's rho)				
		Tax fairness	Tax knowledge	Tax complexity
<b>Tax compliance</b>	Correlation coefficient	<b>0.192**</b>	<b>0.235**</b>	<b>-0.194**</b>
	Sig. (2-tailed)	0.001	0.000	0.001
**. Correlation is significant at the 0.01 level (2-tailed).				

### Discussion and Conclusion

The study is to investigate the significant of individuals' perception towards tax compliance and how tax fairness, tax knowledge and tax complexity affecting those perception in Selangor and Putrajaya. There are three research objectives that have been fulfilled throughout this study. This study concludes that the level of tax compliance in Malaysia is not high but at the same time not too low (moderate). The results also revealed that demographic factors of age, gender and education have no significant differences with tax compliance perception. Meanwhile, income level is significantly differs with tax compliance perception. In addition, the results conclude that tax fairness, tax knowledge and tax complexity are significant towards tax compliance perception. By contrast, high complexity leads to lower tax compliance perceived by individuals. Therefore, it can be concluded that high level of tax compliance can be achieved if the tax fairness and tax knowledge are high and if the tax complexity is low. Thus, government plays a big role to build a trust and develop positive perception among taxpayers so that the level of compliance can be increased.

### Limitations and recommendations

The finding of this study has limitation where only 290 respondents returned the questionnaires with complete answers out of 413 questionnaires distributed. As for the upcoming research, the researchers should expand the data collection throughout Malaysia and not only focusing on certain areas. In addition, there are also some respondents who are reluctant to answer the questionnaires since they thought that the confidentiality of their responses will be exposed and violate their rights. They also assumed that the questionnaires are directly from IRB thus, afraid actions will be taken if found they are not complying with tax regulations.

In addition, this study use three variables only which are tax fairness, tax knowledge and complexity. According to Nkundabayanga et al. (2017), many other factors also can affect the tax compliance such as governmental effectiveness and voice and accountability which have not be considered in this study. Thus, this study is only limited to variables tested in the research only.

Other recommendation is to make continuous collaboration with many agencies including Non-Government Organizations (NGOs) to increase understanding towards importance of tax compliance. This would be useful for taxpayers to know that they are responsible to comply with tax regulations. This is because it is proven in this research and many previous research that knowledge has a great influence in contributing to high compliance among taxpayers.

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