THE IMPACT OF PERCEPTIONS OF TAX COMPLIANCE QUALITY: AN EXPLORATORY STUDY IN MALAYSIA

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ABSTRACT

As the economic factors are insufficient to explain tax compliance behaviour, tax literature evolves to socio-psychological factors. This study extends the "slippery slope framework" to further investigate how perceptions impact on voluntary compliance and enforced compliance. Quota sampling was employed with 340 usable responses from the self-employed group, employed group and student group in Malaysia. SEM Amos was conducted for hypotheses testing in addition to model fit assessment. The findings indicate that perceptions of power of authorities and trust in government enhance both dimensions of compliance quality, whereas trust in tax authorities merely increases enforced compliance. Besides that, conditional cooperation reduces voluntary compliance, while tax awareness enhances voluntary compliance. This paper tested the framework in an Asian context and more importantly, it contributes to the literature by exploring the impact of different dimensions of trust and morale on compliance. Furthermore, findings and inferences would help the policy makers to adapt appropriate strategies to optimize tax revenue.

Keywords : Tax compliance quality, Trust, Power, Conditional cooperation, Tax awareness.

INTRODUCTION

The World Development Indicators conclude that a country level of development correlates significantly with tax revenues (OECD, 2013). In spite of that, inconsistency is observed by Daude, Gutiérrez, and Melguizo (2012). For instance, with similar GDP per capita, tax revenue in Jordan is 33 percent of GDP per capita, as compared to 13 percent in Guatemala. Followed by the economic view, another question is further challenged: Why do the majority of the Ghana's citizens pay taxes willingly, while most of the Serbia's citizens are reluctant to pay taxes? From the tax literature, it seems to be a common conflicting view that taxpayers are more honest in paying taxes than expected (Frey & Torgler, 2007; Kirchler, Hoelzl & Wahl, 2008), yet tax non-compliance has been persisting every now and then (Kasipillai, 2006; Marliza, 2012).

As tax gap substantially exists due to tax non-compliance, tax authorities are anxious to reduce tax evasion and increase voluntary compliance (Pentland & Carlile 1996; OECD 2010). In Malaysia, escalation in illegal economy (Marliza 2012) is alarming with 20 percent-30 percent estimated tax gap[1]. The tax audit framework is issued by the Inland Revenue Board of Malaysia (IRBM) which comes into effect from 1 April 2013, aims to enhance voluntary compliance (to which the tax literatures claim as "enforced compliance") via penalising tax offences include tax non-compliance. Tax compliance outcome is a behavioural action to meet or on the contrary, to infringe the tax compliance standards (Braithwaite, 2010, 2011); where voluntary compliance is the behavioural outcome to comply accordingly without enforcement mechanism (Isa & Pope 2011). Generally, tax administrators would adopt "cop and robber" approach by taking probability of detection, enforcement and fines as useful tools to punish tax evaders. Such deterrence actions also are set as examples for other taxpayers to ensure they pay taxes obediently. Unfortunately, voluntary compliance would not be achievable with the exertion of deterrence power in the long run: More intensive strategic tax behaviour arises as the "fair share of taxes" is always contestable

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[1] Claimed by the director of Inland Revenue Board (IRB) at 2012 MIA International Accountants Conference

with increasing cash economy and aggressive tax planning, which is also known as tax avoidance or minimisation. Resistance defiance may take place with grievance in such command-and-control operational system because taxpayers may perceive the mutual trust between the authorities and themselves has been broken (Braithwaite, 2011). Therefore, it is argued that setting clear border between tax evasion and tax avoidance should not be the focus from the moral point of view (Sandmo, 2005), since both evasion (i.e. infringing law) and avoidance (i.e. exploiting loopholes within legal means) ultimately results in the reduction in tax revenue.

With the arguments above, this paper delves into tax compliance quality instead of identifying tax avoidance and evasion. Using the "slippery slope framework" (Kirchler, 2007; Kirchler et al., 2008) as the basis, this paper's primary objective is to investigate whether perceptions of power, trust, tax morale, conditional cooperation, and tax awareness affect voluntary compliance and enforced compliance respectively.

Provided the earlier forgoing background, this research contributes in comprehending a deeper insight on citizens' perceptions and social influences via studying additional predictors such as conditional cooperation, tax awareness, tax morale and its dimensions, meanwhile enabling the policy makers to realise that the desired compliance outcome could be derived from different compliance behavioural intentions (i.e. voluntary compliance or enforced compliance) for which eventually lead to relatively different tax collections and compliance cost.

The outline of this paper is organised as follows: Second section discusses the theoretical foundation in developing the present conceptual framework and research questions, followed by research methodology in the third section. Forth section contains data analysis with discussions, while concluding remarks and recommendations for future research are discussed in the last section.

THEORETICAL FRAMEWORK

Power of Authorities, Trust in Authorities, and Tax Compliance Quality

In 2008, Kirchler, Hoelzl, and Wahl develop the "slippery slope framework" (Figure 1) integrating economic and socio-psychological factors into "trust in authorities" and "power of authorities" in determining the impacts on tax compliance quality, which comprises voluntary tax compliance and enforced tax compliance. It is empirically tested that enforced compliance is achieved with high power and low trust, while voluntary compliance is achieved with high trust and mixed results for power (Wahl et al., 2010; Kogler et al., 2013). Power of authorities denotes the perception of tax authorities' ability to deter evasion which significantly impacts compliance (Turner 2005), meanwhile correlates with trust with mix results (Lavoie 2008; Kirchler et al., 2008). In this study, we assume power to increase both voluntary compliance and enforced compliance.
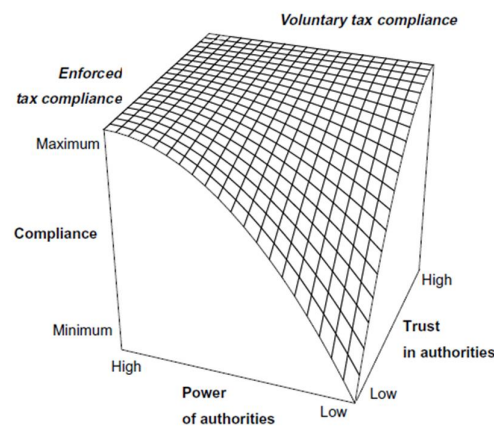
Source: Kirchler, Hoelzl and Wahl, 2008

Figure 1: Slippery Slope Framework

Trust, on the other hand, is a belief that reflects a trustor's expectation about the trustee (Gargiulo & Ertug, 2006). Taxpayers (trustor) who make tax payments would expect tax authorities (trustee) to administer the process effectively and efficiently,

whilst expecting the government would fully utilise the tax revenue for the benefits of the nation and citizens. Interchangeably, tax authorities and government (trustor) would expect citizens (trustee) to meet their tax obligation honestly. While the "slippery slope framework" operationalises "trust in authorities" as a construct to infer how significant trust could impact compliance; we take a step further to expand trust into two dimensions: Trust in LHDN[2] and trust in government. We are specifically referring to generalized trust, a common shared values creating regular expectations of regular and honest behaviour, which is generally extended to whom the trustees without direct interaction (Bjørnskov, 2006). We believe that trust in government takes crucial role to determine compliance quality (Daude et al., 2012). According to Hammar, Jagers, and Nordblom (2009), generalised trusts such as trust in government and legal system are also positively correlated with tax morale (Torgler, 2003) and are vital in determining actual and perceived tax evasion. As it has been widely proven that trust in authorities increases compliance over the world (Cummings, Martinez-Vazquez, McKee & Torgler 2005; Richardson, 2006; Kogler et al., 2013), this research investigates specifically if both dimensions of trust in authorities, i.e. trust in the government and trust in the LDHN, increase compliance quality.

Tax Morale and Tax Compliance Quality

Game-theoretic approach postulates the interchangeable behaviour of being honest and deceitful to maximise taxpayer self-interest under specific situational setting (Greenberg, 1984). However, calculative self-interest is unlikely sustainable in the long run (Williamson, 1993). Over here, we explore the construct of tax morale, an intrinsic value to pay taxes (Alm & Torgler, 2006) into two dimensions: "Self Morale", the self-perceived morale, and "Other's Morale", a reversion of reflecting others' self-interest and the influences on tax compliance. Devos (2008) empirically discovers that tax morale is impactful on compliance outcome though different results may be expected for both dimensions of tax morale due to the tendency of perceiving others with lower morale than oneself (Kaplan, Reckers & Roark, 1988). It

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[2] LHDN stands for Lembaga Hasil Dalam Negari, an official language for tax authorities, the Inland Revenue Board of Malaysia

is expected in this study that both dimensions of tax morale to increase compliance quality.

Conditional Cooperation and Tax Compliance Quality

As the creation of reciprocation is well explained with the introduction of trust game by Blau (1964); Frey and Torgler (2007) further identify the social comparisons and cooperation level affecting compliance behaviour by developing the concept of pro-social behaviour. Conditional cooperation relates to social norms which is an important determinant to compliance (Sigala, Burgoyne & Webley 1999). It is therefore used as an independent variable in this study to examine would one be conditionally cooperative in paying tax according to the social norms they perceive (Rabin, 1998; Falk & Fehr, 2002).

Tax Awareness and Tax Compliance Quality

Apart from the social factors, understanding basic tax law and knowledge such as completing individual tax return correctly (Loo, Evans & Mckerchar, 2010) and awareness of the main purposes of tax collection and one's tax obligation (Devos, 2008) are equally important though there are very few studies differentiating tax knowledge and tax awareness. As this is a behavioural study, we only examine the significance of tax awareness on compliance quality (without considering tax technicalities and knowledge) while it is proven that tax awareness is impactful to the non-evaders' compliance behaviour positively (Devos, 2008).

Research Questions of the Study

Research questions are then developed as follows with the main objective to investigate determinants for both dimensions of voluntary compliance and enforced compliance:

1. Is there a positive relationship between power of authorities and compliance quality?

2(a). Is there a positive relationship between trust in government and compliance quality?

2(b). Is there a positive relationship between trust in authorities and compliance quality?

3(a). Is there a positive relationship between perceptions of others' tax morale and compliance quality?

3(b). Is there a positive relationship between perceptions of self-tax morale and compliance quality?

4. Is there a relationship between conditional cooperation and compliance quality?

5. Is there a positive relationship between tax awareness and compliance quality?

RESEARCH DESIGN AND METHODS

This study is a cross sectional, quantitative research using non-experimental method by employing a five-likert scale survey instrument (1 = strongly disagree to 5 = strongly agree). Pilot study was conducted and questionnaire was refined to enhance the understandability and clarity of the questions and instructions.

The questionnaire was mainly adapted from Wahl et al. (2010) and Rizal (2010) studies. It consists of seven sections with a total of 56 questions. Table 1 lists the section, variable and sources adapted by this study.

Table 1: Questionnaire Variables and Sources

Section	Variable	Sources
A	Trust in Authorities	Wahl, Kastlunger & Kirchler (2010); Kastlunger, Lozza, Kirchler & Schabmann (2013)
B	Power of Authorities	Wahl et al. (2010); Kastlunger et al. (2013)
C	Tax Compliance Quality	Braithwaite (2003); Wahl et al. (2010); Kastlunger et al. (2013)
D	Tax Morale	Devos (2008); Rizal (2010)

Section	Variable	Sources
E	Conditional Cooperation	Rizal (2010)
F	Tax Awareness	Rizal (2010)
G	Demographic Profile	

Quota sampling was applied into three groups: employed, self-employed and university students, with resident status. Any of these groups can be tax registrants paying taxes; tax registrants not exceeding threshold of paying taxes and non-tax registrants. It is argued that non-taxpayers' perceptions are as well significant to be included although they are yet to contribute taxes. And the main reason final year university students were included in this behavioural study is because they would likely be the tax registrants soon upon graduation, hence their perceptions towards tax compliance behavioural intentions are similarly crucial. 1,200 copies of the questionnaires were distributed personally by hand or via email throughout Malaysia, in return of 314 usable responses to proceed with data analysis, of which 106 representing the self-employed group, 124 representing the employed group and 110 representing the university student group. The respondents comprised 145 males (42.6 percent) and 195 females (57.4 percent); 169 Bumiputra (49.7 percent), 120 Chinese (35.3 percent) and 51 Indians (15 percent). Since one third of the samples consist of undergraduate and postgraduate students; employed group was mainly represented by the academics in various universities throughout Malaysia, and self-employed group was represented by agents and practitioners in various workshops and seminars, over half of the respondents were at 18 to 30 years old (58.8 percent), 34.7 percent were at the age of 31 to 50 years old, and only 6.5 percent were over 50 years old. 210 respondents (61.8 percent) were single and the remaining (38.2 percent) were married. There was only 3 percent respondents' education level at STPM and below, 55 percent were diploma or undergraduates, 35 percent were postgraduates, and 7% were professionals in accounting.

The framework is tested empirically through the two-step Structural Equation Modelling (SEM) process: Model fit and validity are initially measured via confirmatory factor analysis (CFA), once the results are achieved at the satisfactory

level, model specification is applied in the second step to test the structural relationship of the model (Hair, 2013).

EMPIRICAL ANALYSIS AND DISCUSSION

Descriptive Statistics

Table 2 shows the measures of dispersion and normality mainly include mean, standard deviation, skewness and kurtosis. Given the mid-point of the five-likert scale as 3.00, mean per item for both trust in government and perceptions of others' tax morale are below the mid-point; conditional cooperation is neutral at mid-point; and the others higher than the mid-point. In general, the respondents acknowledged the legitimate power of authorities (M = 3.49) and have trust in LHDN (M = 3.35), but not expressing much trust in the government (mean = 2.75). Interestingly, they claimed themselves with higher voluntary compliance (M = 3.92) than enforced compliance (M = 3.17). On one hand, respondents perceive higher self-morale (M = 3.17) than others (M = 2.85), and deem themselves with relatively high tax awareness (M = 3.81). Lastly, respondents expressed neutral in conditional cooperation behaviour (M = 3.01). Overall, responses varied and deviated most for self-assessed tax morale (S.D. = 1.12) and trust in government (S.D. = 1.00) followed by perceptions of others' tax morale (S.D. = 0.92) perhaps due to different demographical background and understanding level. Having said that, the distribution of data is assumed to be normal given all skewness and kurtosis of the collected samples range between -1 to 1.

Table 2: Distribution of Mean Scores

	Number of items	Range	Mean per item	S.D. per item	Skewness	Kurtosis
Trust_Government	4	4-20	2.75	1.00	0.17	- 0.64
Trust_LHDN	5	5-25	3.35	0.85	- 0.11	- 0.14
Power	5	5-25	3.49	0.74	- 0.22	0.36
Voluntary Compliance	5	5-25	3.92	0.89	- 0.72	0.28
Enforced Compliance	5	5-25	3.17	0.77	- 0.06	- 0.04

	Number of items	Range	Mean per item	S.D. per item	Skewness	Kurtosis
Morale_Others	3	3-15	2.85	0.92	0.31	0.06
Morale_Self	3	3-15	3.17	1.12	- 0.15	- 0.56
Conditional Cooperation	5	5-25	3.01	0.85	- 0.25	- 0.01
Awareness	4	4-20	3.81	0.82	- 0.56	0.36

Confirmatory Factor Analysis (CFA) measurement model

Confirmatory factor analysis was tested to assess the validity of the framework by examining the fit indices and evaluating the construct reliability. The Root Mean Squared Error of Approximation (RMSEA) was 0.062. RMSEA explains the lack of fit due to misspecification of the model tested. Despite that 0.05 RMSEA value and below indicates a close fit of the model, a value of 0.05 to 0.08 is considered acceptable. Secondly, CMIN/DF, chi-square(x /df) was 2.293. A value below two is preferred, still a value between two to five is considered acceptable. Thirdly, Goodness of Fit Index (GFI) was 0.797, below the recommended minimum value of 0.90. Correlation matrix and composite reliability (CR) were presented in Table 3 and all constructs were reliable with values above 0.70. In order to enhance the model fit, several diagnostic measures were checked and rectified including the path estimates, standardised residuals and modification indices. Two items from the "Morale" construct and one item from the "Awareness" construct with low loadings (i.e., 0.50 and below) were removed. Besides that, modifications were done by setting free for parameters with M.I. 25 and above. After these diagnostic steps, the modified measurement model with improved fit was derived as presented in Figure 2. RMSEA decreased from 0.062 to 0.051 and CMIN/DF reduced from 2.293 to 1.888, indicating close fit within the range of 0.05 and 2.00. Although GFI was still below the recommended minimum value of 0.90 at 0.847, it was improved from 0.797 before modification took place. Subsequently, standardised residuals were reassessed and there were no residuals exceeded |4.0| after removals of low loading items.

Table 3: Correlation Matrix

	CR	1	2	3	4	5	6	7	8	9
1.	0.801	1.000								
2.	0.936	-0.175***	1.000							
3.	0.920	-0.176***	0.602***	1.000						
4.	0.840	-0.160***	0.545***	0.699***	1.000					
5.	0.929	-0.205***	0.332***	0.397***	0.417***	1.000				
6.	0.805	0.083	0.131**	0.268***	0.428***	0.418***	1.000			
7.	0.793	-0.340***	-0.018	-0.126**	-0.064	-0.004	-0.173***	1.000		
8.	0.933	0.200***	-0.082	0.094	0.137***	0.134***	0.255***	-0.198***	1.000	
9.	0.759	-0.130*	0.299	0.433***	0.483***	0.543***	0.340***	-0.076	0.145***	1.000

Significance level: *** $p<0.001$, **$p<0.01$, *$p<0.05$

Note:

1 - Conditional cooperation   7 - Other's tax morale

2 - Trust in government   8 - Self-Tax morale

3 - Trust in LHDN   9 - Tax awareness

4 - Power of authorities

5 - Voluntary compliance (DV)
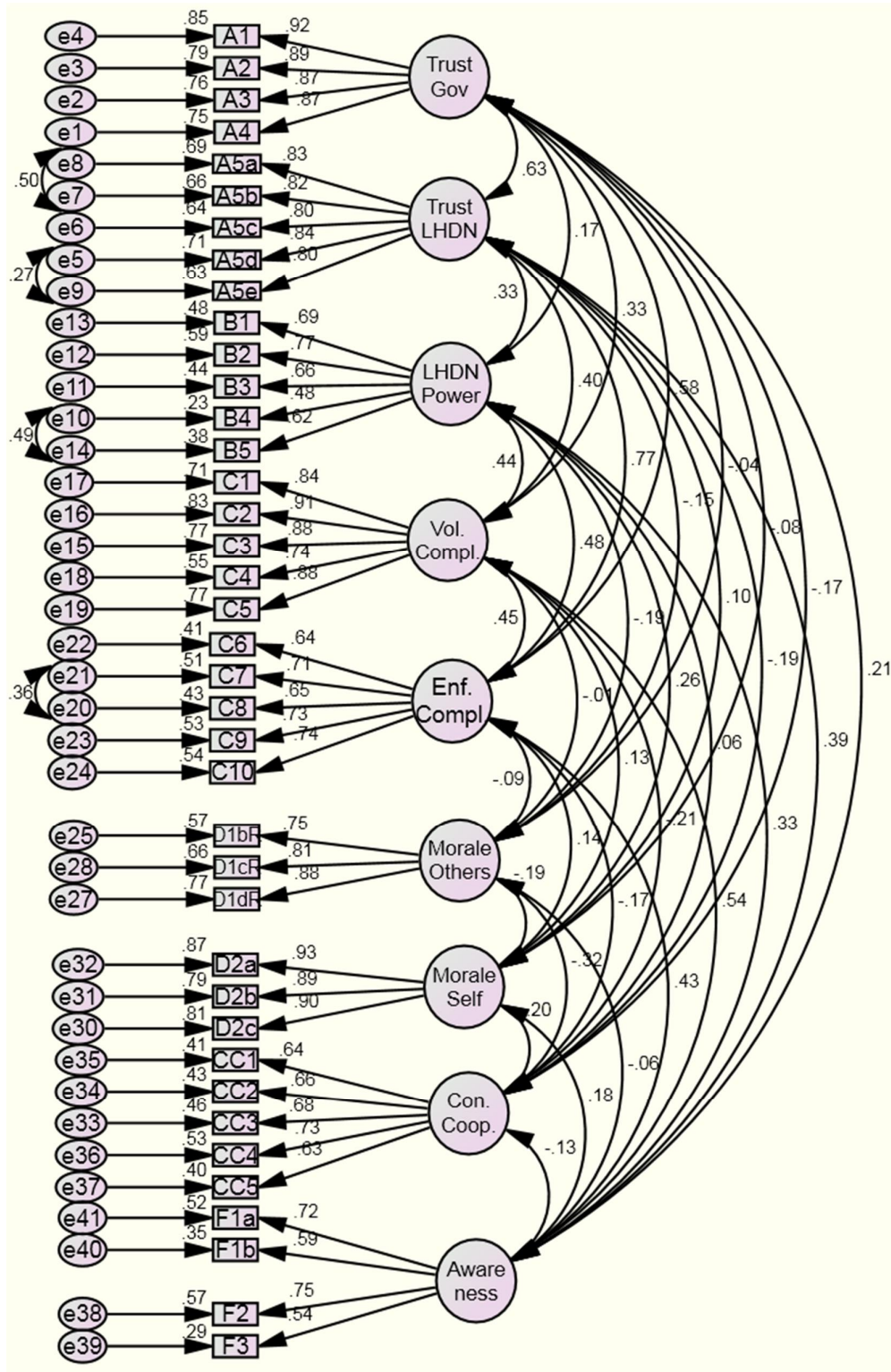
6 - Enforced compliance (DV)

Figure 2: Measurement Model after Modification

RMSEA 0.051, CMIN/DF 1.888, GFI 0.847

Compliance model

The main purpose of specifying the structural model was to test the hypothesised conceptual framework by using free parameters (those to be estimated) and fixed parameters (those fixed at zero). Path diagram is depicted in Figure 3 after setting free the parameters with M.I.35 and above. RMSEA was 0.052; relative chi-square(/) was 1.929; GFI was 0.844. As this is a recursive model, where the paths between constructs are directed only from the predictor construct to the outcome construct, such recursive structural model cannot fit better than the overall CFA model.

This research discovers that trust in LHDN contributes most in enhancing enforced compliance (=0.458, p<0.001), followed by power of LHDN (=0.239, p<0.001), and trust in government (=0.211, p<0.001). On one hand, tax awareness is the most significant predictor to increase voluntary compliance in the model (=0.371, p<0.001), followed by power of LHDN (=0.269, p<0.001) and trust in government (=0.161, p=0.011). Besides that, conditional cooperation reduces voluntary compliance (=-0.139, p=0.021). It is in line with previous findings that trust and power increase compliance (Torgler & Schneider, 2007; Kirchler et al., 2008) with the new finding that calculative trust in tax authorities merely increases enforced compliance, not voluntary compliance. The expanded "slippery slope framework" in this study also further confirms past studies where tax awareness increases compliance (Devos, 2008). While Frey and Torgler (2007) claim that citizens are more willing to pay tax conditionally, this study explores a step and discovers that benchmarking others' behavioural intentions for tax payments will reduce voluntary compliance. Beyond expectation, the concept of "actor observer bias" is supported where respondents tend to claim themselves with high tax morale meanwhile regard others with low tax morale (Kaplan, Reckers & Roark 1988), resulting contradict insignificant results in explaining compliance behaviour.

In sum, the inferences suggest that, if tax authorities adopt deterrence strategies in collecting taxes, they should be aware that perceived trust in tax authorities is highly regarded than perceived power to let citizens to feel the "forces" to pay taxes, and

perception of trust in government also plays a part in increasing enforced compliance behaviour among citizens. If authorities decide to develop synergistic tax climate which attracts voluntary compliance, imparting tax awareness among citizens should be the key area to focus on, then perceived legitimate power so that citizens acknowledge the fair treatment and willingly comply with tax regulations. Perceiving the country is ruled by trustworthy government enhances the willingness to pay taxes with the belief that the government will appoint the eligible authorities to administer tax matters. However, if individuals compare themselves with others and weigh cost and benefits of paying tax, such conditional cooperation behaviour will reduce their willingness to pay taxes unconditionally. It is noted that none of the dimensions of tax morale are supported in explaining the compliance quality. Therefore, it is further explored that actor-observer bias and self-observed bias take place, where individuals are predisposed in assuming tax morale in them and others, causing insignificant results in hypotheses 3. Last but not least, it was estimated that the predictors of enforced compliance explains 59.5 percent of its variance, and 42.2 percent as for voluntary compliance. A summary of these results is laid in Table 4.

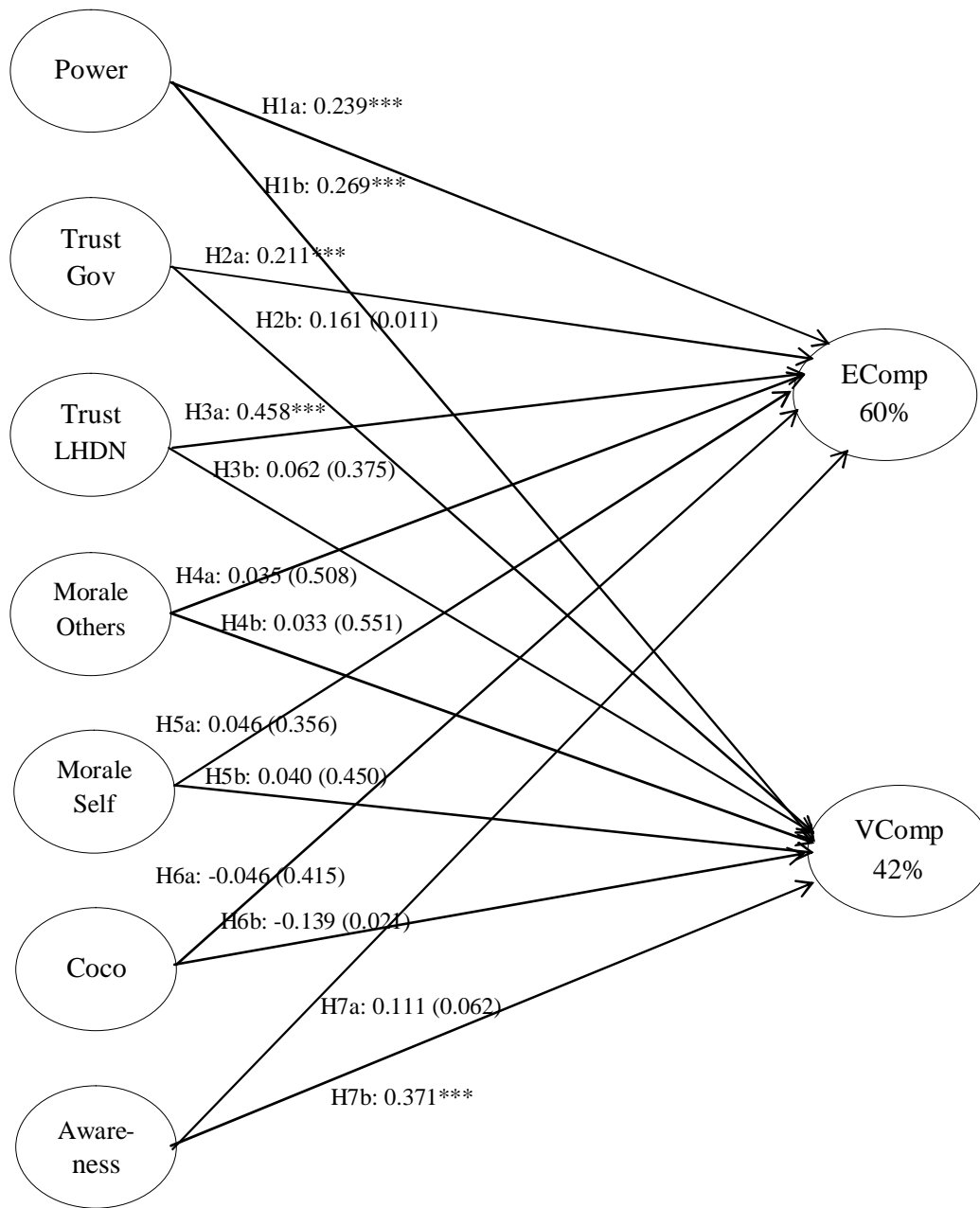RMSEA 0.052, CMIN/DF 1.929, GFI 0.844

Figure 3: Compliance Model

Table 4: Summary of results of hypotheses testing for compliance model

Alternate Hypotheses		Results
H1a:	There is a positive relationship between power of authorities and enforced compliance.	Supported =0.239
H1b:	There is a positive relationship between power of authorities and voluntary compliance.	Supported =0.269
H2a:	There is a positive relationship between trust in government and enforced compliance.	Supported =0.211
H2b:	There is a positive relationship between trust in government and voluntary compliance.	Supported =0.161
H2c:	There is a positive relationship between trust in LHDN and enforced compliance.	Supported =0.458
H2d:	There is a positive relationship between trust in LHDN and voluntary compliance.	Rejected
H3a:	There is a positive relationship between perceptions of others' tax morale and enforced compliance.	Rejected
H3b:	There is a positive relationship between perceptions of others' tax morale and voluntary compliance.	Rejected
H3c:	There is a positive relationship between perceptions of self-tax morale and enforced compliance.	Rejected
H3d:	There is a positive relationship between perceptions of self-tax morale and voluntary compliance.	Rejected
H4a:	There is a relationship between conditional cooperation and enforced compliance.	Rejected
H4b:	There is a relationship between conditional cooperation and voluntary compliance.	Supported = - 0.139
H5a:	There is a positive relationship between tax awareness and enforced compliance.	Rejected
H5b:	There is a positive relationship between tax awareness and voluntary compliance.	Supported =0.371

CONCLUSION AND RECOMMENDATIONS

This study delves into tax literatures to review the significant economic and socio-psychological determinants which are influential to the compliance behaviour before developing a conceptual framework to investigate and explore the constructs which are believed to be crucial and relevant in determining the compliance quality. Although both enforced and voluntary compliance seem to achieve similar compliance outcomes, voluntary compliance is much preferred than enforced

compliance in the long run. As discussed earlier, enforced compliance would lead to strategic tax behaviour over time including aggressive tax planning and tax avoidance.

This paper contributes theoretically and practically by investigating and exploring the significance and impact of the factors on these dimensions of compliance quality. A survey instrument was adapted targeting employed, self-employed and university students with residence status in Malaysia to be the respondents. This study suggests the exertion of power to be one of the fundamental tools to force citizens' compliance behaviour, followed by the perceptions of trust in government. In other words, some citizens are forced to comply due to the probability of detection, and also the calculative trust in government and tax authorities they consider or perceive; whereby some willingly comply knowing that they are always being kept an eye on, and gradually they become discipline in meeting their obligation without grievance, which is contradictory with some studies (Wahl et al., 2010; Kogler et al., 2013). The willingness to comply and pay taxes is in fact very much influenced by the level of trust in government pertinent to the way tax revenues being allocated. As individual perceptions form social norms and subsequently shape the compliance behaviour, the behaviour of cooperating in meeting tax obligation conditionally reduces the willingness to comply. Citizens would only be willing to comply provided their peers are doing the same; or if they have weighed that they are receiving more benefits from the public goods by paying taxes. Moreover, citizens are more willingly to pay taxes if they are aware of their tax obligations and the consequence of not fulfilling their duties. Last but not least, discrepancies were found in this study for both dimensions of tax morale which are supposed to be vital in determining compliance behaviour due to self-response bias and actor-observer bias (Kaplan et al., 1988). Responses in these constructs are not representative because some respondents perceive themselves with high tax morale meanwhile the rests are generally with low tax morale though they withhold the perceptions of low trust high power.

This research is constrained with the limitation of generalizability. Though we use quota sampling method attempting to include self-employed, employed and university students in examining citizens' willingness to pay taxes, we did not

distribute questionnaires on random basis, therefore the samples are not representing the population in Malaysia.

Ideally, future research should attempt to manipulate the variables via experimental design to reduce socially desired responses as much as possible, particularly in developing countries such as Malaysia. It would also be interesting to investigate the difference of tax knowledge and tax awareness in influencing tax compliance as there is so far very little knowledge of literature and empirical studies in examining the two separately. As for this research, we have only proven that tax awareness increases voluntary compliance, and we estimate that tax knowledge could only increase enforced compliance. Certainly, it would be interesting to discover if the findings of this study could be in line with other jurisdictions in the developing and developed countries.

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