

## The Tax Evasion and Compliance: An Exploratory Study on Malaysian Tax Payers

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### Abstract

Recently a considerable research has focused on tax evasion and non-compliance issues. The purpose of this paper is discussing about tax ethics in terms of tax evasion and con-compliance issues. Many Economic researches/studies have revealed that Tax compliance is based on individual decisions on paying and evading Tax compliance. Tax avoidance is no a negligible issue for any country. Because tax is one of the important revenue earning sector for country. This paper introduces the main contributions that have attempted to explain the agreement and obvious disagreement between the evidence on the reaction of taxpayers' attitude towards tax compliance through psychological factors. Some individual preconditions like education, gender, age religion have a relationship for avoiding the tax. The research paper tries to explain the relative importance of these factors affecting the tax payer's intention. The higher educated citizen has higher intent to pay tax. Normally women are less interested to avoid tax. The people who are aged are more interested to pay tax though they know how to avoid this. And also the more religious are more committed to their responsibilities. The research paper helps the government to introduce new policy and regulation to grow the country's economy.

**Keywords:** Tax evasion, Non Compliance issues, Education, Gender, Age and Religion.

### 1. Introduction

Tax evasion and tax avoidance are existing behaviors in all economies in all century. Though everyone knows that the both imply reducing the tax bill, tax evasion is an illegal activity, while the behavior of tax avoidance is legal. Tax avoidance includes not only the use of approaches that allow one to legally minimize tax, but also the search of strategies to exploit uncertainty in the law. For this reason, sometimes the separator line in both phenomena is very small, and it is hard to recognize independently. Normally the term is known as 'non-compliance'. Tax avoidance is not a negligible issue for the development and the growth of the economies of a country.

However, to analyze openly tax avoidance is relevant, not only for the legal and moral issues, but also important topic for other research reasons. For instance, the way to introduce tax evasion and tax avoidance in an economic model has to be different, since the obtained returns have deferent in the natures. The return from tax evasion is dependent, because it includes the probability to be auditing. However, the return from tax avoidance is known from the beginning since there are no probabilities, neither penalties nor fines. Therefore, the contingency or not of these phenomena generates an important difference between them.

Furthermore, the effects that some variables (for example education, gender, religion) have on both behaviors could be opposite. The effect that human capital has on tax avoidance is clear. To avoid taxes is necessary to have some skills, achieved with the educational level. Thus, the reported results for the relation between the taxpayer's educational level and the avoidance and aggressive tax planning behavior are undoubted. Researchers tested that tax avoidance increases over time because taxpayers learned successful techniques to shelter gains from taxes.

The vast majority of articles that have been written about tax evasion have been written from the perspective of public finance. They discuss technical aspects of tax evasion and the primary and secondary effects that tax evasion has on an economy. In the past decades, the issues of tax evasion and non-compliances gradually become serve topic for the country in the worldwide. There are several reasons are identified for the issue of tax evasion and non-compliances.

The scholars have identified four prime factors which leading the tax evasion and non-compliance be happened including education, religion, age and gender. Indeed, origin for the tax evasion is linked with the law ad directly economy. Where this can influence the relevance of ethical and sociological motives. In detail the tax complies deal with the human issues. Furthermore the prior researchers are revealed that if we follow the strategy made by the government, we can overcome the both, means tax evasion and non-compliance. The necessity of education is important for the youth group for having a clear concept about tax. Religion is also important factor which can be the motivator to do honesty and appropriate with their action. The effect of incremental of aging for the gender implies the maturity of an adult to fulfil his or her social responsibility away from tax evasion and non-compliance.

#### 1.1 Education

Education has interrelationship with the happening of unethical tax ethics problem and issues. Though each of nations apply their own technique and unique education program for educating their citizens especially with the tax ethics. Basically ethics codes are the priority concerned for the organization to defeat the unethical problems in tax ethics. Ethic codes functioned as reflecting concurrent organizational values, expressive principals and standards as well as identifying ethical issues and providing necessary solution (Ross &

McGee, 2011)<sup>[17]</sup>. The ethic codes have bring significant effects on taxpayer ethics which is the prime education concerned to prevent the tax unethical issues. On other hand the tax payer's ethics reflects the components of financial self-Interest and commitment of moral. And this moral and ethics can only learned by education.

Researchers always include education level in their studies as a control variable. In general, the higher the education level ones possesses, the higher the respect ones would pay to the laws and more opposed to tax noncompliance, and vice versa. (Ross & McGee, 2011)<sup>[17]</sup>. However, it is contradicted with the result found by Stulhofer (2007), that tax noncompliance increases with education level. Witte and Woodbury (as cited in Ritsema, *et al.*, 2003) and Obid (1994), found a positive relationship between education level and non-compliance, whereas, a negative relation has been found by (Dubin & Wild, 1988) supported that education is negatively related to tax non-compliance (Dubin & Wild, 1988; Obid, 2004)<sup>[3, 13]</sup>. Ross and McGee (2011)<sup>[17]</sup> found no evidence to prove that education level affect tax compliance level, as none of the t-test showed significant different (Ross & McGee, 2011)<sup>[17]</sup>.

Education may influence an individual in his / her decision making towards tax non-compliance. This is because, people can comprehend tax laws better with certain education level, hence, become more compliant as they realize their obligations and duties towards the government and even towards the country. Ross and McGee (2011)<sup>[17]</sup> mentioned that more complexity in tax non-compliance it would be, if one possesses a higher education level. With more understanding of tax system, may misuse the knowledge to find ways searching for weaknesses and loopholes in the tax system and try to evade tax. (Ross & McGee, 2011)<sup>[17]</sup>

## 1.2 Gender

Numerous studies had included gender as one of the independent variables into the tax non-compliance or tax evasion research field. Ross and McGee (2011)<sup>[17]</sup> (Ross & McGee, 2011)<sup>[17]</sup> studied more than 20 demographic variables of Malaysians towards tax evasion (non-compliance), found that, women in Malaysia were more opposed to tax noncompliance than men (Ross & McGee, 2011)<sup>[17]</sup>. However, the result was tested at the five percent level and finalized that the difference was not significant ( $p=0.1174$ ).

A study conducted by Gërzhani (2007), which delved into the gender differences towards tax evasion in Tirana, Albania. The study explained the differences in tax behaviors between men and women under the application of new institutional theory, which determined institutions as the imperative framework by focusing on the social and legal norms. In other words, it means that, the researcher tried to explain differences in tax behaviors between men and women through his activities which embedded within the framework of human interaction. The reason for this is to optimize the decision making by individuals. Two forms of institutions are incorporated into this framework, namely formal and informal institutions. Formal involves rules and regulations, while informal refers to social norms. The study revealed that almost 27 percent higher possibility that men would evade tax than women in terms of personal income, small-business income and extended to social security and health insurance which was distinctively shown. Yet, the analysis concluded that the gender differences towards tax noncompliance cannot be fully illustrated by the new

institutional theory, due to the country's concentration of labor market, where mostly women work in government sector while most men work in private or own business.

In addition, Kaplan, Pany, Samuels and Zhang (2009)<sup>[10]</sup> concluded in their findings that females has higher intention than males in terms of fraudulent reporting, which may lead to more opposed to fraudulent, like tax non-compliance (Kaplan, Pany, Samuels, & Zhang, 2009)<sup>[10]</sup>. Hai and See (2011)<sup>[6]</sup> confirmed that gender has a positive influence on non-compliance behavior of sole-proprietors in Batu Pahat District (Hai & See, 2011)<sup>[6]</sup>. Kasipillai and Jabbar (2006) who also investigated gender differences towards tax compliance in Malaysian context, however, claimed that there are equal or similar aversion towards tax non-compliance between men and women, where gender does have a direct influence to compliance attitude but not the compliance behavior, the reason founded to this is due to their perception towards the Malaysian tax system. (Jeyapalan & Hijattulah Abdul, 2006)<sup>[8]</sup>. The result was similar with the outcome of survey conducted by Jackson and Milliron (as cited in Kasipillai & Jabbar, 2006), which found a mixed result on gender differences towards tax compliance (Richardson, 2006)<sup>[16]</sup>. Some studies provided significant statistical evidence that women are more opposed to evade tax than men do (Akaah, 1989; Harris, 1990; Ross & McGee, 2011)<sup>[1, 7, 17]</sup> Some empirical studies have found that men are more ethical than women (Friedland, Maital, & Rutenberg, 1978; Kirchler, Hoelzl, & Wahl, 2008; Ross & McGee, 2011)<sup>[4, 11, 17]</sup>. Yet, other researches have concluded that there is no statistical different between men and women, where people are equally averse to tax non-compliance (Jeyapalan & Hijattulah Abdul, 2006)<sup>[8]</sup>. This shows that there is no absolute finding towards this variable.

## 1.3 Religion

Religion, according to the Oxford Dictionary (2012), is a system of faith and worship or human recognition of a superhuman controlling power, and religiosity is defined as the quality of being religious. (Johnson, Jang, Larson, & De Li, 2001)<sup>[9]</sup>, defined religious commitment or religiosity as "the extent to which an individual is committed to the religion he or she professes and its teachings, such that individual attitudes and behavior reflect this commitment". Apparently, the term "religion" is very complex to describe (Pargament, Magyar-Russell, & Murray-Swank, 2005)<sup>[14]</sup>. This is because "the roots of religion are so numerous, the weight of their influence in individual lives so varied, and the forms of rational interpretation so endless, that uniformity of product is impossible" (Allport, 1950, p. 26). However, it is interesting to note that religion in the form of specific religious beliefs and practices helps to define an individual's motivation and personality that go beyond the basic desires to gain rewards or to avoid self-punishment (Allport, 1961, p. 301). Religiosity had not been widely recognized in tax compliance research as one potential element that might explain the puzzle of tax compliance, several researchers emphasized its importance. (Stack & Kposowa, 2006; Torgler, 2003; Welch *et al.*, 2005)<sup>[20, 22, 23]</sup>

It may be simply viewed as a belief in God (or gods) or other spiritual beliefs in determining the extent to which people fully meet their legal tax obligations within any developed or developing country. This may be related to the argument made by Margolis (1997, p. 247) that religious faith can supposedly

provide moral constraints to distinguish and choose between good and bad behavior in any religion. This concept is important as much of the tax literature investigates the role of moral values held by individuals towards tax compliance. Whilst religious people would of course be expected to have high moral values, atheists may also have similar high values. An individual may use the internal elements such as moral beliefs and/or religious beliefs to decide whether or not to comply.

Stalans, Smith and Kinsey (1989, p. 503) supported this by stating that normally, many taxpayers use their inner values in the decision-making process. Therefore, there is indeed moral belief without religion, which may be based on respect for other people, animals and the environment. In other words, in a tax compliance research context, the role of religiosity is different from that of moral values, although within any tax paying population there may well be some commonality.

Amongst the earliest studies, Tittle and Welch (1983, p. 676) explored individuals' perceptions of the relationship between religiosity and deviant acts, and one of those acts was tax evasion. They suggested that the characteristics of religious communities will determine the effect of an individual's religiosity on deviant behavior in the future. Welch, Tittle and Petee (1991) used data collected from Catholic parishioners and it was evident that tax evasion was negatively related to an individual's private religiosity. Likewise, the effect of informal sanctions was found to be effective in curbing certain types of deviance such as tax evasion in a socially integrated church community (Petee, Milner, & Welch, 1994) <sup>[15]</sup>. The findings were similar probably because the same source of data was employed in both studies. Strong religious beliefs were expected to prevent illegal behaviour through self-imposed guilt, particularly in the case of tax evasion (Grasmick, Bursik and Cochran, 1991, p. 263) <sup>[5]</sup>. Grasmick, Kinsey and Cochran (1991, p. 104) <sup>[5]</sup> not only explored the effects of church attendance on tax cheating, but also measured affiliation as an index of religious importance. They discovered that those with no affiliation were more inclined to cheat. (Grasmick, Bursik, & Cochran, 1991) <sup>[5]</sup>. Torgler (2003b, p. 297) <sup>[22]</sup> has undertaken extensive research on the role of religiosity and the findings initially revealed that tax morale depends positively on religiosity using the WVS data for 1990 in Canada. He also responded to the suggestion made by Riahi-Belkaoui (2004, p. 141) to explore religiosity in order to fully understand tax compliance problem by covering more than 30 countries using specific data from the WVS (1995-1997) and confirmed the same findings. (Torgler & Schneider, 2007) <sup>[21]</sup>. His research then explored the determinants of tax morale in various countries and found a strong impact of religiosity on tax morale in Germany (Torgler & Schneider, 2007) <sup>[21]</sup>.

While research findings generally indicate positive relationships between religiosity and tax compliance or negative relationships between religiosity and tax evasion. The perceptions of tax evasion within a community were found to have a similar effect on the community members regardless of their levels of religiosity. (Welch *et al.*, 2005) <sup>[23]</sup>. This is probably because, as strongly emphasized in Christianity. (Ross & McGee, 2011) <sup>[17]</sup> Or even in Islam (Jalili, 2012, p. 192), tax evasion can either be perceived as ethical or unethical, depending on the way a country is administered and whether the government strictly or only partly follows the religion's laws. Similarly, no empirical evidence supported religiosity as one of the factors that influenced tax morale. It is argued that

the personal integrity of individuals has a stronger effect on their tax compliance attitudes compared to their own religious beliefs. Although inconclusive, the overall literature shows that religiosity may play a vital role in helping authorities to meet their target in fostering voluntary tax compliance.

#### 1.4 Age

Most of the researches have concluded that older taxpayers are more opposed to tax non-compliance than younger taxpayers (Bosco & Mittone, 1997; Wenzel, 2002) <sup>[2, 24]</sup>. This may be due to older taxpayers may be wealthier than younger taxpayers who are still struggling in accumulating their assets and strategizing to evade tax by underreporting income or overstating deduction. Besides, Wenzel (2002) <sup>[24]</sup> explained that older taxpayers may be more familiar to the tax system by utilizing their tax deduction and can plan their taxation wisely contrary to younger taxpayers. However, Browning and Zabriskie (as cited in Ross & McGee, 2011) <sup>[17]</sup> stated that younger people are more ethical. Whilst, Akaah said that age is not a factor in affecting tax non-compliance. (Akaah, 1989) <sup>[1]</sup>. Hai and See (2011) <sup>[6]</sup> tested that age variable has a positive influence on noncompliance behaviour. However, the study did not mention which group of age is more tax non-compliant. (Hai & See, 2011) <sup>[6]</sup>. While many other researcher confirmed that age has a positive effect on compliance level. (Friedland *et al.*, 1978; Slemrod & Sorum, 1985) <sup>[4, 19]</sup>. Yet there are also some studies revealed a negative relation between age and non-compliance. Ross and McGee (2011) <sup>[17]</sup> which conducted a demographic study of Malaysians, presented that the result was not straightforward, the ANOVA and t-test failed to provide any significant difference. It shows that age is not a determination in Malaysia. (Ross & McGee, 2011) <sup>[17]</sup>

In relation to the mixed results, four possible explanations were proposed by Richardson and Sawyer (Richardson, 2006) <sup>[16]</sup>. First, not all taxpayers are influenced by age in their behavioral decision. Second, researchers may define taxpayers' non-compliance differently. Third, the impact of age on tax noncompliance is attenuated when age is tested with other variables, and finally, the interaction of age with other variables is restless.

Moreover the perspective view of sociology research, when the people are get older means they have seen the unfaithful and unethical problems in half of their life, this will lead them understanding the negatively impacts could be occurred if the unethical issues particularly on tax ethics problems existing among the society. Although the people will more understand the importance of culture that influence the balancing of tax ethics in the community by shifting the method from religion to the faith and trustful method that promote a well culture and society.

## 2. Findings

There are numbers of study conducted factors for tax evasion. On the basis of those studies the different factors that will affect the perception of tax avoidance such as education, religion, age and gender.

### 2.1 Education

Based on the study conducted by McGee and Tayler we found that the variance between middle and upper group were minor. But the lower group is tends to more opposed to tax evasion than the middle and upper group. (Welch *et al.*, 2005) <sup>[23]</sup>. In

other hand one of Vietnamese study states that the higher level educated was less opposed to tax evasion. (Ross & McGee, 2011) <sup>[17]</sup>.

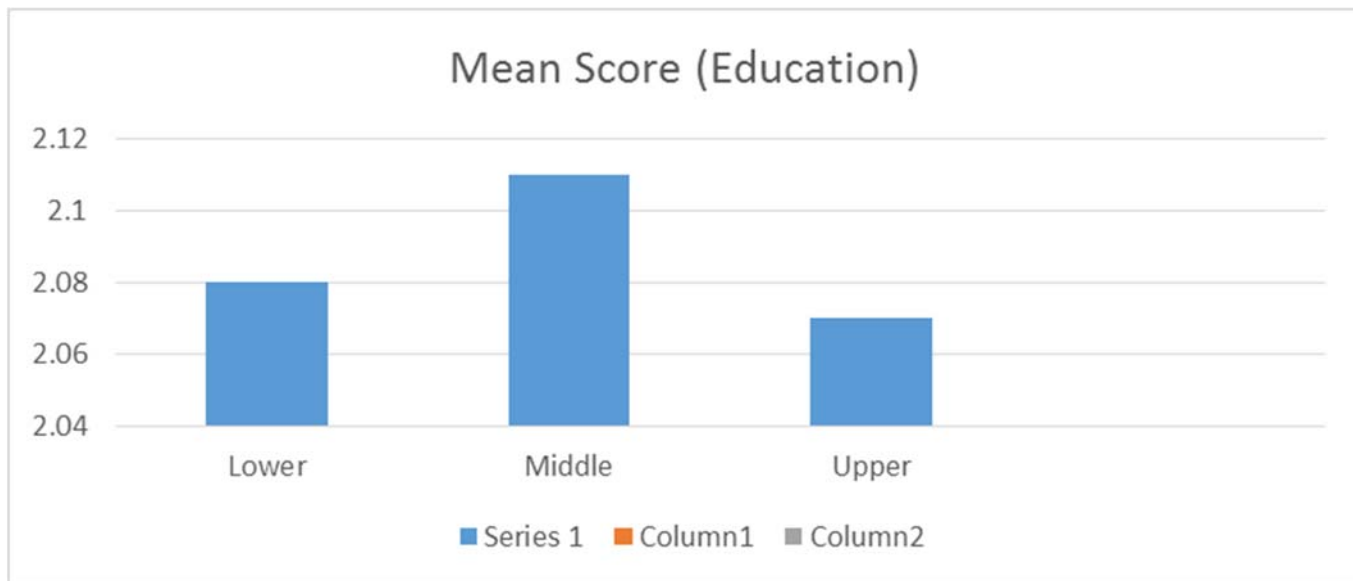


Fig1: Mean Score- Education

From the above figure it presents that the education level of lower, middle and upper which obtain from Inglehart *et al.* study. The result showing that the people in middle educated tends to be more opposed to avoid their tax responsibility if they have the chance or opportunity. (McGee, 2006).

### 2.2 Religion

Beliefs in religion is another element that is often associated with general ethics as well as tax ethics in specific. Based on research of Torglar, religion has a good or positive effect on tax ethics which the specific religious confession was not statistically vital (Torgler, 2003) <sup>[22]</sup>.

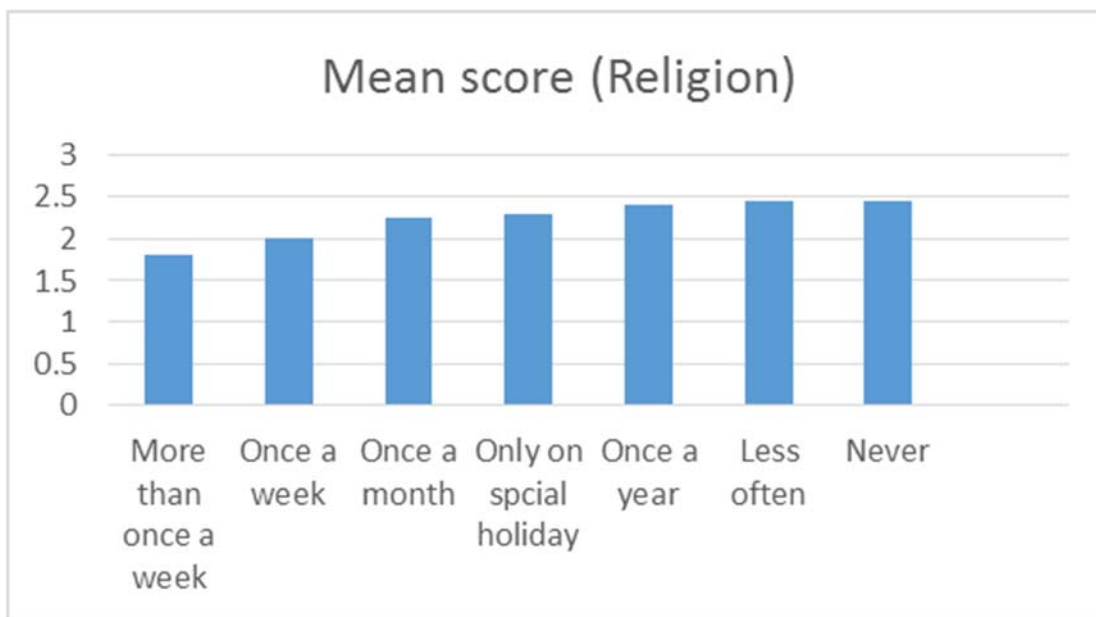
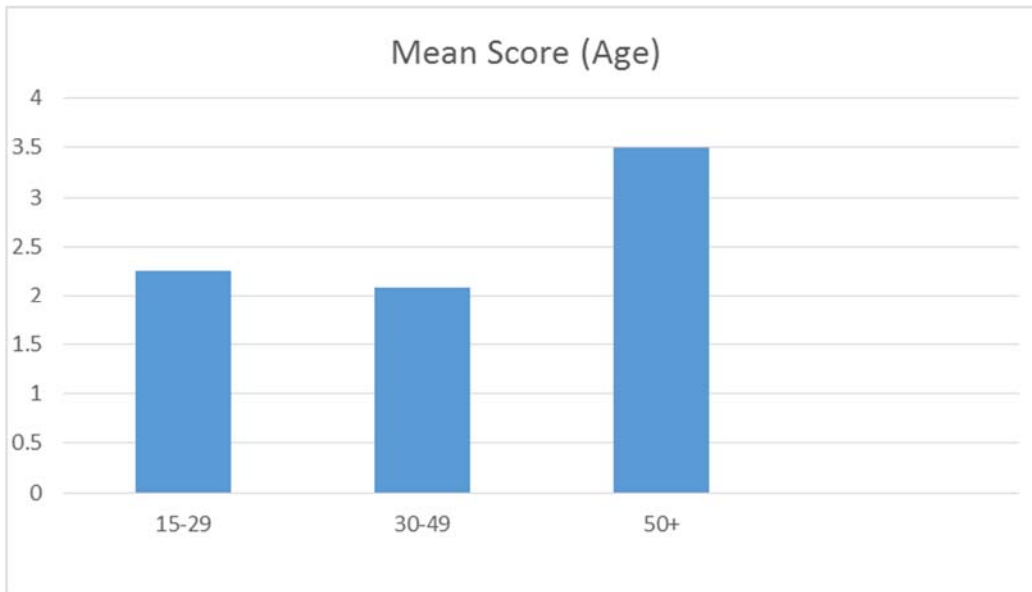


Fig 2: Mean Score- Religion

The result shows it is more likely to have a direct relationship between the frequency of attendance and the attitude towards tax evasion or in other words cheating on taxes while there is a chance. From the above results, it indicated that people who have higher attendance of service are less likely to involve in tax avoidance. And the people who less often or never attend any services have higher tendency to do cheat on tax.

### 2.3 Age

The people with higher age group have higher intention to pay tax. (Ross & McGee, 2011) <sup>[17]</sup>. Beside this Emin Babakus also found that age will make a difference in tax avoidance but sometimes it also depends on culture.

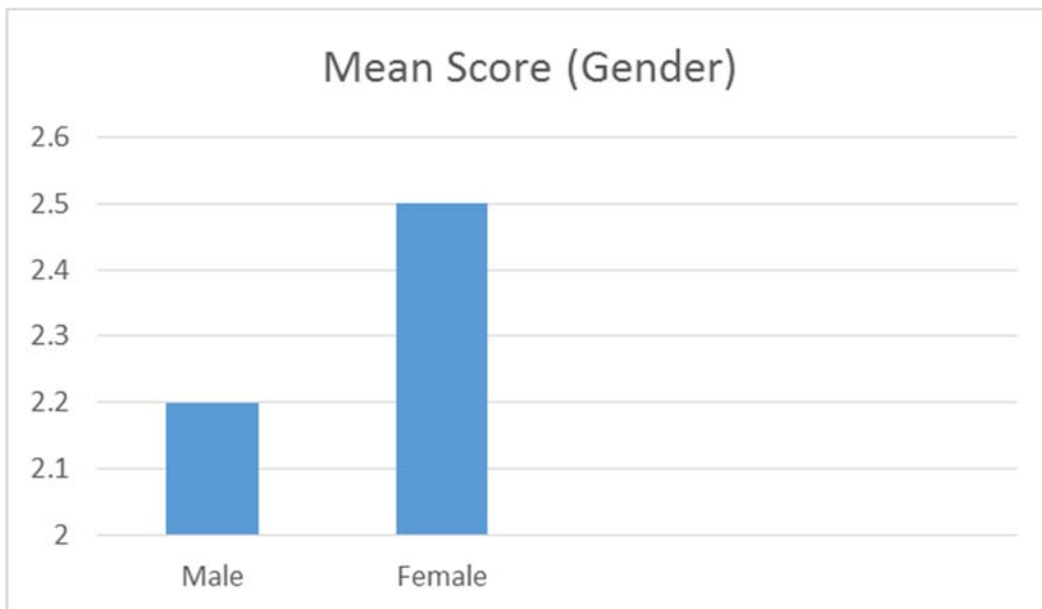


**Fig 3:** Mean Score (Age)

From the result it indicates that people within the higher age group has higher tax ethic which will less likely involves in tax avoidance or cheating on tax and vice versa. (McGee, 2006).

#### 2.4 Gender

Different studies showed that female are more ethical than men. On the other hand, some of the studies also found that there is no differences between male and female attitude due to male and female in different countries will have different attitude towards tax evasion.



**Fig 4:** Mean Score- Gender

The result indicates that male is more likely to involve in tax evasion than female if they have a chance. However none of them very like to avoid taxes.

#### 3. Recommendation

- Professional education should strengthen for tax issues.
- The members of religious sector should put effort in encouraging their discipline to fulfil their responsibility to pay taxes.

- Lecturers regarding tax ethics should be given from teenagers. It will help younger to understand the importance of tax.

#### 4. Conclusion

In conclusion the study shows us certain assistance for government in terms of government able to design some tax policy measuring in reducing effect of tax evasion on the country's economy. The findings might also help the policy makers to set up some rule and regulation or precaution measure

towards unrecognized factors previously in solving the problem of tax evasion.

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