



Perception on justice, trust and tax compliance behavior in Malaysia



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ABSTRACT

The relationship between justice and trust with tax compliance behavior in Malaysia was studied. Previous studies have acknowledged the perception that justice does have an impact on tax compliance. This study distinguishes justice into procedural justice, distributive justice, and retributive justice. Therefore, this study examined the effect of these three types of justice on tax compliance. Trust also influences the act of tax compliance and it also has a relationship to the element of justice. Perceptions from individual taxpayers were gathered using questionnaires from previous studies. The findings suggest only procedural justice and trust affect tax compliance and procedural justice was positively and significantly correlated to trust. However, trust does not mediate the relationship between justice and compliance. This research will contribute to the tax literature with widened scope on justice in Malaysia.

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Introduction

The Malaysian tax system is currently practicing a Self-Assessment System (SAS) which empowers taxpayers to assess, determine, and pay their tax liability in accordance with tax legislation. This system encourages taxpayers to be more transparent and responsible in their tax computation. Nevertheless, some taxpayers may try to manipulate their financial matters to reduce their requirement to pay tax or even to make it zero (Murphy, 2004).

Considering the possibility, the Inland Revenue Board of Malaysia (IRBM), as the Malaysian tax authority, take efforts to cope with the non-compliance issue. As an example, civil

and criminal tax investigation in high profile cases has been conducted to increase tax compliance. In 2013, 588 cases with tax penalties of MYR 485.6 million for civil tax investigation were completed (Inland Revenue Board of Malaysia, 2013). In the same year, 29 reports based on criminal tax investigations were completed involving MYR 24.8 million (Inland Revenue Board of Malaysia, 2013). In 2014, 618 cases of civil and criminal investigation were settled (Inland Revenue Board of Malaysia, 2014). Other than that, under Section 104 of the Malaysian Income Tax Act 1967, taxpayers who fail to pay their tax liability will be prevented from leaving the country. Consequently, 25,811 income taxpayers were barred in 2014, with tax arrears amounting to MYR 494.94 million.

The statistics indirectly reveal evidence of non-compliance by taxpayers in Malaysia even when strict actions have been taken by the Malaysian authorities. Non-compliance may happen due to their perception of justice

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that influences their action (Saad, 2009). This is more so in a situation where the taxpayers think that individuals with the same economic standing or income must be taxed at the same rate (Gravelle & Gravelle, 2006). In other words, taxpayer with the same income, wealth, and liability must be taxed at the same rate.

Justice is also one of the four characteristics of a tax system, as discussed by Adam in 1965 (as cited in Lymer & Oats, 2009). The principle of justice emphasizes that individuals must be taxed according to their ability and has been explained in terms of horizontal and vertical justice. In horizontal justice, individuals with the same income must be taxed at the same rate or be subject to the same tax liability. Vertical justice distinguishes individuals from different income positions (Barjoi, 1987).

Thus, perception of justice in the tax system is seen to influence the level of compliance among taxpayers. A few studies have found that taxpayers are more inclined to comply when a country's tax system is perceived to be fair and just (Alm, Cronshaw, & McKee, 1993; Azmi & Perumal, 2008; Gilligan & Richardson, 2005; Richardson, 2005).

The current study is different from previous studies on the subject of justice. First, previous studies adapted various dimensions and used factor analysis to measure the perception of justice in terms of vertical justice, horizontal justice, justice exchange, and administrative justice, among others. According to Wenzel (2002a), findings derived from factor analysis depend on the suitability of the measure to the analysis where a dimensional concept could not be determined in empirical research. He introduced a justice framework as a guideline for systematic measurement in studying the role of justice on the behavior and action of taxpayers. Wenzel (2002a) classified justice into procedural justice, distributive justice, and retributive justice which are commonly used in social psychology. Therefore, this study will examine the relationship between these three types of justice with tax compliance. Several studies found that there is a relationship between the three types and tax compliance.

Second, this study also differs from previous studies on justice conducted in Malaysia such as by Azmi and Perumal (2008), and Saad (2009, 2012). Azmi and Perumal (2008) used justice dimensions developed by Gerbing (1988) and the results showed that a perception of justice exists in Malaysia. However, the study did not unearth the impact of the perception of justice with regard to tax compliance. On the other hand, Saad (2009, 2012) studied the role of the perception of justice on tax compliance as well as the impact of tax knowledge and tax complexity on justice. Saad (2009) found that taxpayers perceive the current tax system in Malaysia as fair; however, there is no evidence showing that this perception influences tax compliance behavior. The same finding was also reported by Saad (2012) for the perception of justice on taxpayers in Malaysia and New Zealand. Taxpayers in Malaysia were found to be significantly more positive regarding the tax system in Malaysia compared to taxpayers in New Zealand. However, taxpayers in New Zealand were more compliant compared to Malaysian taxpayers.

Third, this study will also examine the relationship of the three types of justice with trust on tax authority and its relationship to tax compliance because trust is also an

indicator to assess the authority's level of procedural justice (Konovsky & Pugh, 1994). Trust has been found to be able to influence tax compliance. For example, studies done by Wahl, Kastlunger, and Kirchler (2010) and Kastlunger, Lozza, Kirchler, and Schabmann (2013) found high trust regarding the tax authority could increase tax compliance. Kirchler (2007) classified trust as a factor which has a positive and significant relationship with increased tax compliance. In addition, the current study determines the relationship between distributive justice and retributive justice and trust which has not yet explored. This study will examine the impact of these factors (justice and trust) on tax compliance.

Currently, no thorough study has been reported to identify the relationship between the perception of procedural justice, distributive justice, and retributive justice with regard to tax compliance in Malaysia. Therefore, this study is an effort to fill the gap. The main objective is to determine the relation between the perception of justice in terms of procedural justice, distributive justice, and retributive justice as well as trust with tax compliance behavior in Malaysia. Furthermore, this study will examine the relation between the three types of justice with trust.

Previous Studies and Hypothesis Development

Relationship Between Justice and Tax Compliance

According to Murphy and Tyler (2008), if taxpayers are treated nicely and fairly by the tax authority, they will cooperate and be more inclined to comply with the decisions made by the tax authority. Wenzel (2002b) found procedural justice could predict the compliance level of taxpayers in Australia. From his study, taxpayers are more compliant when they believe that tax officers serve them fairly and with respect. Procedural justice refers to the perception of the service or treatment received by individuals from the authorities (Murphy, 2009) and it also relates to the process of resource division by the authorities (Kirchler, 2007).

Taxation research on procedural justice showed a positive impact on tax compliance. Empirical studies indicated that if an individual perceives that the authority is exercising a fair, existing procedure, they are more likely to trust the authority (Murphy, 2004) and more compliant with any decision made by the tax authority (Murphy & Tyler, 2008). However, previous studies on procedural justice have not reported consistent findings. Some researchers reported that procedural justice has a positive impact (van Dijke & Verboon, 2010), while others have reported different findings (Worsham, 1996).

Previous studies have acknowledged the effects of distributive justice on tax compliance behavior. Distributive justice refers to the perception of how far the input provided can garner the expected result in achieving equity (Adams, 1965; Walster, Walster, & Berscheid, 1973).

Most studies found distributive justice to have an impact upon tax compliance. Taxpayers evade tax payment when they believe there is injustice in the exchange relationship between taxpayers and the government (Kim, 2002; Porcano, 1984; Verboon & van Dijke, 2007). Taxpayers not receiving public exchange from the government believe injustice happens. The same situation applies when

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