STUDY ON FAIRNESS AND INDIVIDUAL TAX COMPLIANCE IN MALAYSIA: PRELIMINARY FINDINGS

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ABSTRACT

The objective of this study is to examine the effect of fairness on tax compliance in Malaysia. Besides examining the overall effect of fairness on tax compliance in Malaysia, this study also segmentized fairness to distributive fairness, procedural fairness and retributive fairness. The distinction is to emphasize the relation between fairness and inconsistent tax compliance behavior. This study was conducted using questionnaires, with participation of 82 academician respondents. Result shows that the respondents believe in perception that fairness could influence their tax compliance behavior. However, only procedural fairness have positive and significant correlation with tax compliance. Meanwhile, distributive and retributive fairness only bear positive but insignificant correlation.

Key words**:** Fairness and tax compliance.

Introduction

Fairness is one of the must have characteristics in tax system. Fairness refers to situation whereas a taxpayer is taxed according to their capability (Lymer & Oats 2009). Generally, fairness is distinguished by horizontal and vertical fairness. Horizontal fairness is individuals with the same income taxed at the same rate or bearing the same tax liability. On the other hand, vertical fairness differentiate individuals with the different income (Barjoyai 1987). Total tax payable depends on total income receivable. Taxpayer with higher income have to pay higher tax and vice versa. The higher the income, the bigger the proportion of tax needs to be paid.

Therefore, fairness in tax system is seen to influence level of compliance of taxpayers. This was proven by a study done by a few researchers such as Richardson (2005); Kim (2002); and Hartner et al. (2008). Their findings conclude that taxpayers are more inclined to comply when there is a perception of fairness in a country's tax system. Unfairness only weakens the tax system (Gilligan & Richardson 2005) and caused resistance from the taxpayers to pay their taxes.

Most studies on fairness used factor analysis to measure the perception on fairness which includes various dimension to gauge perception on fairness such as vertical fairness, horizontal fairness, exchange fairness, administrative fairness, and others (Richardson 2005; Kim 2002; Anna & Perumal 2008). According to Wenzel (2002a), findings from factor analysis depends on the suitable measurement with the analysis whereas the concept of dimension could not be decided in an empirical study. Hence, Wenzel (2002a) introduced fairness framework as a systematic measurement guideline to assess the role of fairness on the behavior and trend of taxpayers.

Wenzel (2002a) distributed fairness into three types namely procedural, distributive and retributive fairness which are usually used in social psychology. Social psychology studies research more on the social dilemma that exists in determining priorities and cooperation of an individual. An individual needs to think of the impact of the actions on the society (Wenzel 2002a). This issue is not unknown in taxation. Taxpayers acted upon actions that may give impact to the society. Previous studies are more focused on distributive fairness rather than procedural or retributive fairness (Kirchler 2007). Research on perception of fairness have also been conducted in Malaysia, however the finding show fairness does not implicate tax compliance. For instance, study by Anna and Perumal (2008) only studied the taxpayers' perception on fairness of the tax system without determining the impact on tax compliance and only focuses on distributive fairness. Meanwhile, Natrah (2009) and (2011) found that taxpayers believe Malaysian tax system is fair however there is no evidence showing it correlates to tax compliance.

Therefore, besides analyzing perception on fairness in Malaysia, this study aims to specifically utilize all three types of fairness and assess its impact on tax compliance. It is highly important to analyze and differentiate the types of fairness to gather

taxpayers' perception whether all three types of fairness exist in Malaysian tax system and which of the types have correlation to tax compliance.

This study first laid out on research on fairness and tax compliance and afterwards construction of hypothesis. In the next part, research methodology is explained and the study is concluded with discussion of research findings.

Fairness And Tax Compliance

Society's perception on whether a tax system is fair and just is very important as previous studies in Verboon and van Dijke (2007); Kim (2002); Hartner et al (2008); and Murphy (2009) successfully proven that positive perception results in good compliance behaviors. If such perception exists, voluntary compliance also increase (Richardson 2005). Researchers such as Alm et al. (1993) and Roberts and Hite (1994) found that taxpayers are less compliant if they perceive unfairness exist in the existing tax system. Therefore, some researchers verified that fairness have significant correlation with tax compliance (seperti Richardson 2005; Natrah 2012). This means that discrepancies in tax reporting by taxpayers will happen when perception of unfairness rise.

Gerbing (1988, in Roberts & Hite 1994) used thorough fairness dimension, exchange with government, wealth tax, progressive tax rate and individual priorities in measuring perception of fairness. The result shows five dimensions exist in tax system. On the other hand, study by Christensen et al. (1994) identified five factors of fairness which are personal payment, exchange with government, special provision and overall fairness.

Richardson (2005) in his study assess the relations between perception of fairness by taxpayers and their cross cultural compliance trend in Australia and Hong Kong. The same five dimensions used by Gerbing (1988) were utilized and results show significant correlation between perception on fairness and tax compliance. In the following year, he conducted a study on the impact of fairness perception on tax compliance in Hong Kong by adding on a new dimension which is middle income earners. All dimension of fairness exist in Hong Kong and affected tax compliance.

In Malaysia, studies on perception of fairness were done by Anna and Perumal (2008); Natrah (2009) and Natrah (2012). Study by Anna and Perumal (2008) used the same dimensions as Gebing (1988) to measure perception on fairness and the result shows the dimensions exist in Malaysia. However, the study did not research on the dimension of perception of fairness having impact on tax compliance. Meanwhile, Natrah (2009) and Natrah (2012) studied on the role of perception of fairness on tax compliance and the impact of tax knowledge and complexity on fairness. Result from Natrah (2009) show taxpayers believe that current tax system is fair, however there is no evidence showing that it influences compliance behavior. The same result also was shown by Natrah (2012) which studied perception of fairness of taxpayers in Malaysia and New Zealand. Malaysian taxpayers are more positive perception on fairness compared to taxpayers in New Zealand. However, New Zealand taxpayers are more compliant and execute their tax liability compared to Malaysian taxpayers. Therefore, the following hypothesis is constructed to assess the impact of perception of fairness on tax compliance in Malaysia:

H1: Fairness is positively correlated to tax compliance.

Distributive Fairness, Procedural Fairness, Retributive Fairness And Tax Compliance

Distributive fairness refers to fair exchange of resources that includes cost and benefits (Kirchler 2007) by comparing individual contribution and the outcome of the contribution (Adam 1965). Resources include materials or non-materials, positive or negative such as tax burden (Wenzel 2002a).

Most study show distributive fairness has impact on tax compliance. Taxpayers evade tax when they perceive unfair exchange between taxpayers and the government (Porcano 1984; Kim 2002; Verboon & van Dijke 2007). Taxpayers who did not receive public exchange from the government believe unfairness happen compared to those who receive public exchange. The same situation applies when a taxpayer disagree with the government spending policy or perceive they receive unfair exchange from the government, they will feel suppressed and not comply with tax system (Kim 2002).

Moser et al. (1995) in their study proved non-compliance to tax happen when a respondent is taxed higher than other taxpayers and receive inadequate public exchange to their tax payment. The higher the return from tax payment received, the higher is the tax compliance (Alm et al. 1992a; Alm et al. 1992b). According to dimension of distributive fairness, taxpayers look at 'exchange' on tax paid. If they perceive that the 'return' commensurate, they are more inclined to voluntary tax payment and afterwards the level of tax compliance within taxpayers will also increase. Therefore, the following hypothesis is constructed:

H2: Distributive fairness is positively correlated to tax compliance.

Meanwhile, procedural fairness focus on the perception whether fair procedures and services are executed by the authority (Murphy 2009; van Dijke & Verboon 2010). If the society perceive that the method for resource distribution is fair, therefore procedural fairness is high (Kirchler 2007). Generally, procedural fairness is an important factor in determining the relationship between authority and the public (De Cremer & Tyler 2007; van Dijke & Verboon 2010; van Dijke et al. 2010). If an individual perceive that the authority execute fair procedures, they have more trust to the authority (Murphy 2004).

According to Murphy and Tyler (2008), if good and fair services are received by taxpayers from the authority, they will cooperate and will be more inclined with the decision made by the tax authority. Wenzel (2002b) found procedural fairness could forecast the level of compliance of taxpayers in Australia. His study shows taxpayers are more compliant as they perceive that tax officers treated them fairly and with respect.

However, previous studies on procedural fairness did not produce consistent result. Some researchers reported positive impact of procedural fairness (van Dijke & Verboon 2010), while some other researchers failed to show such result (Worsham 1996). Hence, the following hypothesis is developed:

H3: Procedural fairness is positively correlated to tax compliance.

Finally, retributive fairness is related to perception of taxpayers on suitable punishment on tax crime (Kirchler 2007). Perception on retributive fairness usually exist when taxpayers perceive unfairness exist and their rights are not observed when a taxpayer whom commit a wrong goes unpunished. Also, when a taxpayer perceives that the penalty imposed upon them is not fair and not commensurate to the wrong done (Wenzel 2002a). Therefore, fair and just punishment to the wrong one must be implemented to instill fairness (Natrah 2011).

Suitability of the punishment imposed is important to increase retributive fairness in tax system and later increase tax compliance. Besides punishment which is a negative type of retribution, reward is a positive retribution given to compliant taxpayers which also influences compliance behavior (Falkinger & Walther 1991; Feld et al. 2006). There is not much studies done to assess the relations between retributive fairness with tax compliance (Kirchler 2007). This is due to retributive fairness is closely related to interaction between taxpayers and the tax authority as with procedural fairness (Kirchler 2007). Kastlunger et al. (2009) also suggested the need for further research to assess rewards on audit effectiveness, penalty, and incentives. The following hypothesis is constructed:

H4: Retributive fairness is positively correlated to tax compliance.

Research Methodology

Data of this study was gathered from field work using questionnaires with Likert scale to determine agreement on the statements given (5 points Likert scale, 1 = highly disagree, 2 = disagree, 3 = not sure, 4 = agre dan 5 = highly agree). Questions were adapted from previous studies on three dimensions of fairness which includes procedural fairness adapated by Murphy (2009) established by Tyler (2006), distributive fairness from Verboon and van Dijke (2007) and retributive fairness from research done by Natrah (2011). Questions were edited according to suitability of Malaysian condition.

400 questionnaires were distributed to respondents whom are academicians and at the point this article is prepared, 82 questionnaires were returned (20.5 percent). The following is a descriptive analysis of the respondents involved:

Table 1: Summary of respondents' background

	Respondents (n=82)	Percentage
Gender:		
Male	28	34.1
Female	54	65.9
Monthly gross income:		
< RM2,700	1	1.2
RM2,701-RM4,000	8	9.8
RM4,001-RM6,000	38	46.3
RM6,001-RM8,000	19	23.2
RM8,001-RM10,000	12	14.6
> RM10,000	4	4.9
Level of education:		
Degree	2	2.4
Masters	56	68.3
PHD	24	29.3
Number of years of work experience:		
< 1 year	3	3.7
1-4 years	16	19.5
5-9 years	19	23.2
> 10 years	44	53.7
Organization:		

Public learning institutions	55	67.1
Private learning institutions	27	32.9
Position:		
Professor	0	0
Associate professor	6	6
Senior lecturer	28	28
Lecturer	47	47
Assistant lecturer/Tutor	1	1
Number of time filing income tax return:		
Never	3	3.7
Once	9	11
2-5 times	22	26.8
> 5 times	48	58.5

Hypotheses testing

Simple linear regression analysis is used to test hypothesis 1 with model $y = \beta_0 + \beta_1\chi_1 + \varepsilon$ in the representation of y = compliance trend, χ_1 = fairness dan ε = error. Multiple regression analysis is used to test hypothesis 2,3, and 4 based on the following model:

$$y = \beta_0 + \beta_1\chi_1 + \beta_2\chi_2 + \beta_3\chi_3 + \varepsilon$$

y	=	Compliance behavior
χ_1	=	Distributive fairness
χ_2	=	Procedural fairness
χ_3	=	Retributive fairness
ε	=	Error

Table 2 and 3 show result of the analysis. Table 2 shows fairness could influence compliance behavior in Malaysia with positive and significant relationship ($\beta = 0.39$) even though it only explains 15.2 percent compliance rate. Therefore, hypothesis 1 is justified. Meanwhile, Table 3 all types of fairness showing positive correlation to compliance behavior ($\beta = 0.111$; $\beta = 0.405$; $\beta = 0.054$), however only procedural fairness influences compliance behavior ($p = 0.000$). This result only supports hypothesis 3. In overall, the research model explained only 17.9 percent compliance behavior.

Table 2: Result of Regressions

	$F_{(1,80)}$	R^2
Outcome: Compliance **Predictors:** **Fairness**	14,321*	0.152

*Significant at 0.01

Table 3: Result of Multiple Regressions

	$F_{(3,78)}$	R^2
Outcome: Compliance Predictors:	5.681*	0.179
Distributive fairness (χ_1)		
Procedural fairness (χ_2)		
Retributive fairness (χ_3)		

*Significant at 0.01

Result of the analysis shows that respondents believe that fairness in overall could influence tax compliance rate. When this fairness is distinguished into three types namely distributive, procedural and retributive, only procedural fairness could increase tax compliance. This shows services rendered by tax officers is fair and just. Respondents also believe Malaysian tax authority

execute fair existing procedures which resulted in their compliant with the tax system. On the other hand, distributive and retributive fairness are also positively correlated with compliance but have no influence on their compliance behavior.

Conclusion

Perception on fairness of tax system could increase tax compliance. Therefore, this study analyzed the effect of the perception on tax compliance in Malaysia in overall. Meanwhile, fairness is distinguished to distributive, procedural and retributive fairness as suggested by Wenzel (2002a) to analyze which fairness could increase tax compliance in Malaysia. From the findings, it could be summarised that respondents believe perception of fairness influence their tax compliance behavior. However, respondents believe only procedural fairness influence their compliance when tax authority treat them fairly during taxation procedures that are undertaken against them. Fairness in exchange and fair punishment did not influence their compliance behavior. This study is limited in responses as it is still in the initial stage of research.

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