

TAX COMPLIANCE COSTS AND TAXPAYERS BEHAVIOUR: A REVIEW STUDY

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ABSTRACT

Tax compliance cost and its impact on taxpayers' behavior has received less attention compared with other topics in tax context. In addition, it is not clear how the tax compliance cost can predict the taxpayers' behavior. For this reason, this study aims to review and examine the literature and identify the relationship between tax compliance cost and taxpayers' behavior. Articles related to the topic was extracted from main databases, filtered, screened, reviewed, and analyzed. The findings indicate that there are two types of compliance cost. The first is internal while the second is external. In value, the external is higher than the internal. The findings also showed that most of reviewed studies have examined the issue of tax compliance among enterprises such as SMEs and large enterprises. In addition, studies in developed countries and emerging economies far outperform the studies in developing countries. Sample size of the reviewed studies is considered large with the majority of the studies are quantitative. The effect of tax compliance cost is negative and more severe and large for the SMEs compared with large enterprise.

Keywords: Tax Compliance Cost, Tax Compliance Behavior, SMEs, Taxpayers

Introduction

In the history of tax compliance, it is widely accepted that there is high importance of the tax compliance cost. For this reason, researchers differentiate between economic approach and behavioral approach. The economic approach is known by using power and legitimacy to enforce taxpayers to comply with tax. However, the behavioral approach is to control the predictor of the tax compliance and reduce the cost of compliance. Previous studies in this regard are divided between the two school of thoughts. The first call for implementing the economic approach, which is costly while the second call for implementing the behavioral approach, which is to some extent less costly but might lead to weak revenue of tax.

However, before examining the existing frameworks and model, the meaning of tax compliance must be clarified. Individuals are considered to comply with tax when they are willingly paying their tax duties without having to enforce them to do so by law and regulation (Ahmad, Mohammed, Iskandar, Hanefah, & Faizal, 2014; Hanefah, Ariff, & Kasipillai, 2002). Mainly, tax compliance is divided into material compliance and formal compliance. The material one occurs when the taxpayers obey to tax rules and regulation. The formal one is happened when the taxpayers meets the obligation by law and related acts (Al-Zaqeba, Hamid, & Muhammad, 2018).

Nevertheless, when it comes to the compliance cost, previous studies when dealing with the compliance have focused on the variables that lead to the tax compliance either the behavioral or the economic one while the relationship between compliance cost and compliance behavior has not been widely investigated. This topic is important because when the cost of compliance is high, the taxpayers will receive less services for the tax that they have paid and this might change their attitude and intention to comply with the tax. Since there is few studies in this field and the literature is not certain regarding the relationship between the two constructs, this study aims to review the literature and identify the relationship between tax compliance cost and the taxpayer behavior.

The study also aims to provide researchers and decision makers with suggestions and recommendations for future work and policy adjustment regarding the tax approach and behavior. The following sections deals with the literature review, methodological approach, findings, direction for future work, and conclusion.

Research Methodology

Since this study is a review study, there is a need to clarify the methods through which the study has selected the related articles. Specific databases that are interested in the topic of tax compliance were selected and searched for related articles. Key words such as tax compliance, compliance cost, and tax compliance cost, taxpayers behavior and a combination of these words were selected to find the articles. Next, the search in databases such as Science Direct, Scopus, Web of Science, and IEEE was done. As a results, a total of 231 articles were identified. The inclusion criteria are articles between 2010 to 2020, written in English and focuses on tax compliance behavior and cost of tax compliance behavior. Exclusion criteria includes non-tax compliance behavior, non-English articles and articles before 2010. Several screening were conducted to eliminate the articles that are duplicated or out of scope as well as outdated articles. In the first screen, the articles that are duplicated were removed. This reduced the articles to 142. The second screening was conducted to remove the articles that are outdated (less than 2010), none English, or out of scope. This was conducted by examining the title and abstract of the articles. This has reduced the number of articles to 74 articles. Further, the last screening was conducted by full reading of the articles. These process resulted in 29 articles that suit the topic of this study. Figure 1 shows the process of selecting and refining the articles of this study.

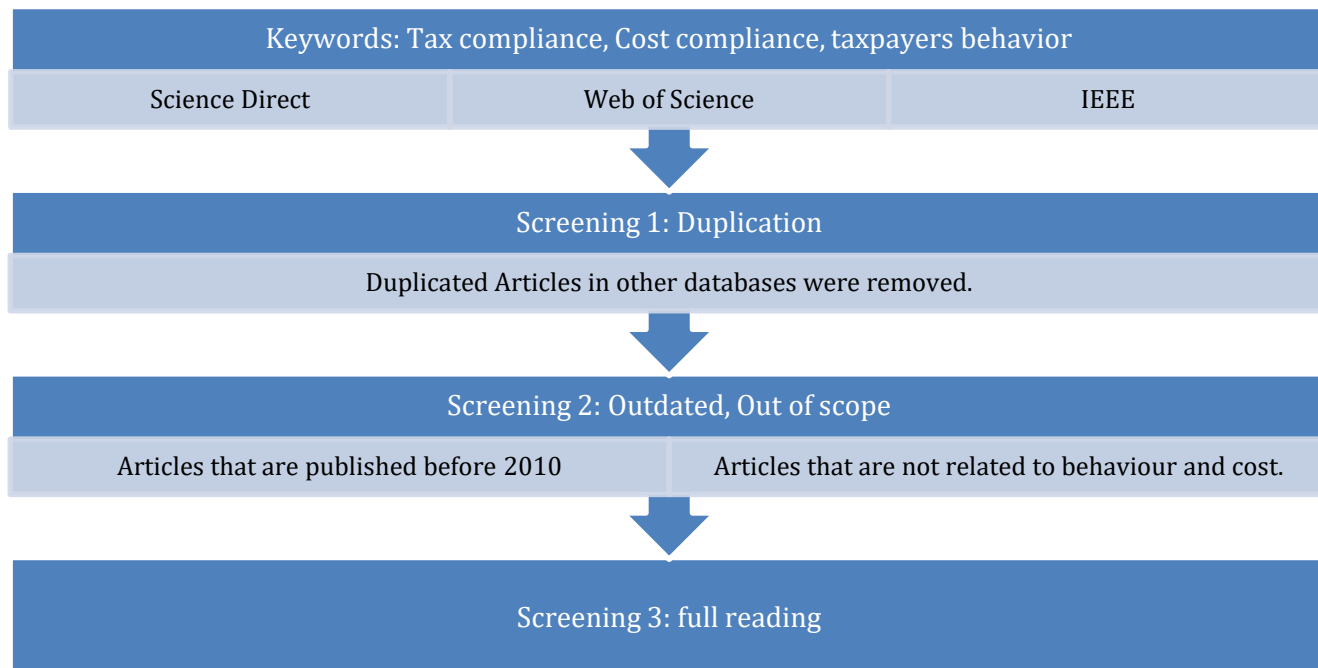


Figure 1: Process of Selecting Articles

Literature Review

In this section, an overview of the tax compliance cost and the taxpayer behavior is discussed.

1. Tax Compliance Cost

Tax compliance cost is an important topic for researchers and policy makers (Evans, 2003). Sapiei (2013) pointed out that tax cost is one of the important topic that policy makers are trying to solve and increase the tax compliance while reducing the cost of compliance. Eragbhe (2014) indicated that the cost of compliance is defined differently by researchers and it is mainly related to the cost that are paid by the tax collectors or the individual to comply with the tax. Jabbar (2009), and Gupta et al. (2014) suggested that the meaning of cost compliance as equivalent to charges paid by citizens in addition to their tax to meet the prerequisites of their tax. Gupta et al. (2014) concentrated on the personal expense of cost compliance. Cost compliance are brought by citizens in arranging and agreeing to the tax assessment framework. Cost compliance expenses are grouped by their sources and types, both inward and outward, or arranging and amount, individually. Jabbar (2009) called attention to that the external compliance cost is the charges covered to outside government obligation experts, for example, legal counselors and bookkeepers. While, the internal compliance cost are related to the time and monetary costs that are acquired inside the business.

Accordingly, researchers differentiated between two type of compliance cost. The first by business organization while the second by individuals. For the cost compliance of business, it incorporate the expenses of gathering, bookkeeping, and transmitting cost on the pay rates and wages of its employees. In addition, it includes the cost of complying with tax the fine if there is no compliance as well as the legal cost of preparing the tax. In case of individual, the cost include the cost of preparing the tax documents and the fees for accountants or tax agents as well as the time that is spent in preparing and paying the tax. In includes also the cost of travelling (Eragbhe et al., 2014).

2. Compliance Costs and Taxpayers Compliance

As indicated by Evans (2014), compliance cost increased from 2% to 10% of collected tax revenue and up to 2.5% of GDP. The increase in tax compliance is associated with the increase of tax cost compliance. Evans et al. (2016) uncovered a few distinctive highlights of the compliance costs profile of companies in Australia. Companies in Australia demonstrate an affinity to depend on help of law offices for their assistance in preparing tax documents. Second, by the type of external cost compliance, "record keeping and cost documenting" was just 37% of the absolute external compliance cost by large companies (while this administration represented 80% of the all-out outside expenses caused by SMEs in Australia).

Maseko (2014) showed that compliance cost is altogether, contrarily identified with assessment compliance conduct. The respondents were having contradiction and disappointment with the measure of cost that brought about in filling expense form, procure charge specialist, and travel for cost reason as they might suspect those compliance expenses are unjustifiable. High compliance cost brought about lower engaging quality of nation to the remote financial specialists. Manual and Xin (2016) uncovered that compliance cost has a critical association with compliance behaviour of independently employed citizens. Be that as it may, the outcome uncovered that cost compliance has a critical association with compliance behaviour of independently employed citizens. Susila (2014) noticed that, expense impediment hypothesis depends on the idea that, if the result of perpetrating a wrongdoing exceeds the advantage of the wrongdoing itself, the individual will be hindered from carrying out the wrongdoing.

Ibrahim (2014) found that respondents invest the vast majority of their energy meeting cost compliance with a normal of 11.7 hours per respondent. While the E-recording devoured 9.84 which implies that, by and large, e-documenting spared about 3.4 long stretches of time. Sapiei and Ismail (2014) show that cost compliance necessities for enterprises incorporate complete government forms, keeping up appropriate records, and getting adequate information to empower these compliance to be precisely executed. The inward outside costs proportion was 37 percent and 63 percent, separately, showing that there is an overwhelming dependence on outer sources.

A portion of the proof shows that SMEs seem to have had the option to evade from complying with tax. There are two primary kinds of tax compliance costs. The first is the monetary cost and the second is the mental cost. For the monetary cost, it includes the amount of the tax as well as the expenses associated with paying the tax such as travel, preparing the tax, and the time spent in paying the tax. The mental cost include the estimation of stress and tensions coming about because of consenting to comply with laws (Evans and Tran-nam, 2014).

Eragbhe (2014) separated compliance cost into regulatory costs, time spent, money costs and mental costs, beginning and repetitive costs, bookkeeping expenses, computational expenses and arranging costs and inner and outer expenses. in Nigeria are exposed to various kinds of expenses, coming up next are sorts of assessments that they are relied upon to consent to (1) organization annual cost (2) esteem included expense (3) instruction charge (4) traditions and extract obligations and (5) worker charge (payee)/individual personal cost and retaining charge.

Abdul and Wang'ombe (2018). look at the impact of proportions of compliance costs on compliance behavior among SMEs in Kenya. The discovering shows that compliance cost in Kenya fundamentally decreases with increment in expense compliance costs, especially those identified with comprehension of the current complex cost laws, changes in cost governs just as general expenses of gathering the compliance and administrative necessities. Adam et al. (2017) found that the vast majority of expenses are firmly identified with data preparing exercises, for example, record keeping and documenting assessment forms alongside information.

Savitri and Musfialdy (2016) found that the compliance costs is related to several factors such as the age of the business, the bookkeeping information of the respondent, the utilization of an outside

specialist organization and the kind of bookkeeping framework. The outcomes uncover the critical determinants per expense type, empowering a correlation made over the distinctive assessment types. The findings showed that revenues of tax compliance has a significant association with the internal compliance costs. The examination affirmed that there is a higher relative weight for small organizations in regard of inward annual assessment and workers' compliance exercises.

The relationship between compliance cost and compliance behavior was investigated in Tanzania by Mahangila in (2017) who found that compliance cost have a noteworthy negative effect on compliance behavior. These outcomes were reliable crosswise over orientations, regardless of female members being seen as fundamentally more consistent than male. The discoveries were likewise predictable over the age gatherings and training levels.

Eichfelder et al. (2014) found that the relationship between compliance cost and compliance behavior is multifaceted in nature. While the compliance of employees and large organization is low, there is clear proof on high compliance among SMEs and citizens. Wu and Tran-Nam in (2017) found that compliance cost are extremely high. It includes a huge work segment: for instance, time required to round out structures, and expert administrations costs for overseeing charge undertakings. Nonetheless, a breakdown of compliance cost is hard to get, for the undeniable explanation that compliance expenses are not consistently watched.

The finding of Ramli et al. (2015) recommended that the compliance costs among SMEs in conforming to GST are critical contrasted with the SMEs' anticipated net gain. Tran-Nam (2014) demonstrate that, regardless of the Australian Government's promise to impose disentanglement, the Australian expense framework has been seen by cost specialists as complex. Ioannis et al. (2016) reasoned that annual compliance costs increment with firm size. An expansion in firm age brings about lower personal expense compliance costs.

The investigation of Defeng and Hua (2017) planned to distinguish the expenses of cost compliance on the compliance behavior. The study found that there is significant association between the two variables. Susila (2014) also reported that there is association between compliance cost and the compliance behavior. Juddoo (2014) found that every large organization may depend more on tax agent. Likewise, most of organizations have critical authoritative advantages in cost compliance as the organization has utilized mechanized bookkeeping frameworks. In Europe, tax compliance cost have been progressively troubling among organizations that wish to build the proficiency of assessment frameworks. Specifically, the issue has pertinence to the business that must distribute the assets that can be spent on the business and basic to address the costs charge compliance.

Stamatopoulos et al. (2017) found that the expansion in possession by organizations claimed by personal cost compliance expenses is a typical property, which is the situation for organizations working around the world. They did not discover any relationship between the compliance costs and the area in which the organization works. Savitri and Musfialdy (2016) noticed that bringing down the expenses of compliance can improve the efficiency and intensity of small firms, which may thusly enable these organizations to apply more assets to their center business exercises and furthermore increment their capacity to work and pay more tax. Gobena et al. (2016) found that citizens utilizing PCs in their expense bookkeeping frameworks were found to be more complied with tax and has low compliance cost than others. Organizations with larger board size and large number of departments were found to have lower compliance costs than those with smaller board size and less departments.

Findings

Based on the selected articles, the findings can be discussed based on the type of compliance cost, the target of previous studies, the country, the sample, and the relationship between compliance cost and taxpayers compliance.

1. Type of Tax Compliance Cost

The findings of this study divided the tax compliance cost into internal and external. The internal cost is the cost paid by the taxpayers and it is related to time cost, money cost, opportunity cost and planning cost. The external cost is also further divided into tax agent and tax services. The selected articles support the opinion that external cost is higher than the internal cost.

2. Target Respondents of Selected Articles

The target respondents of selected articles is given in Figure 2. It shows that 10% of the reviewed articles investigated the compliance cost of individual taxpayers while 15% has focused on SMEs. A total of 25% have focused on the large enterprises. Mixed studies which focused on SMEs as well as large enterprises accounted for 50% of the reviewed studies.

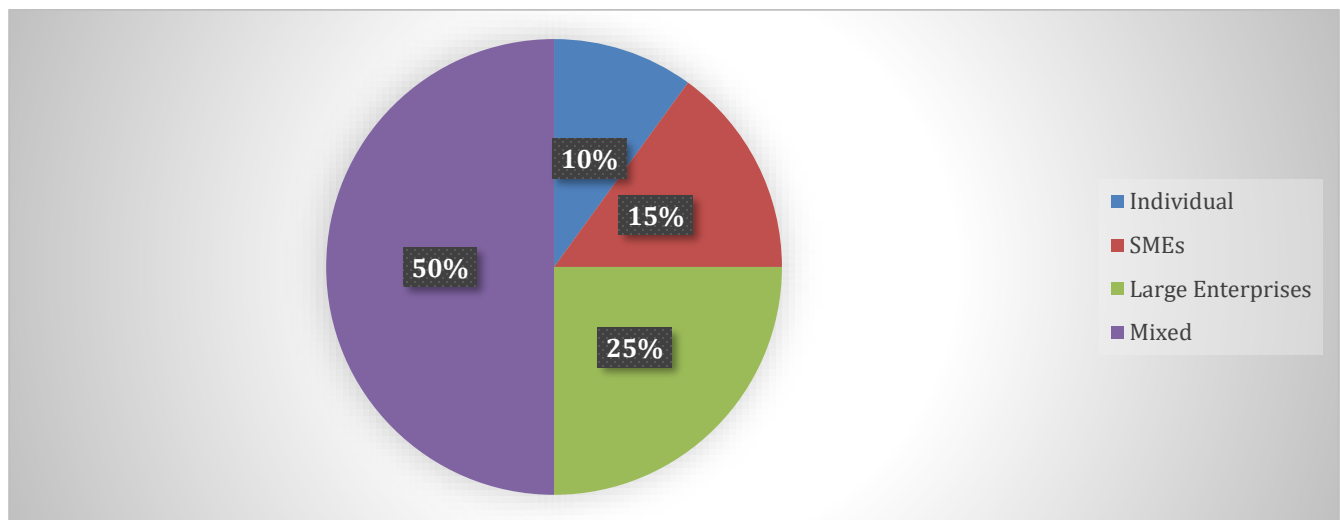


Figure 2: Focus of Reviewed Studies

3. Country of the Selected Articles

The selected articles comes from different countries and continent. The highest percentage of articles comes from Australia New Zealand and Nigeria with 18% for each. This is followed by Malaysia and USA with 14% for each. China received 9% of the reviewed articles while countries such as Jordan and Tanzania received 5% and 4% respectively.

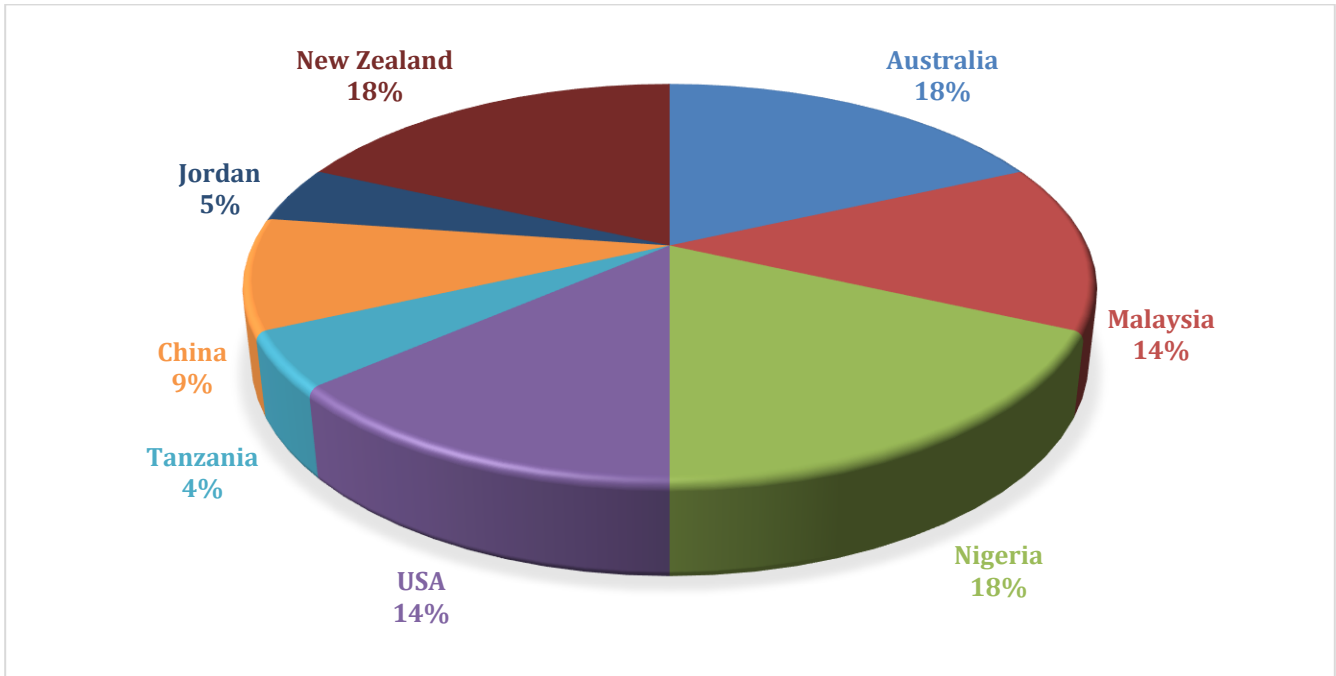


Figure 3: Country of Origin

Sample Size

Most of previous studies were quantitative in nature and they collected data either secondary data or primary data using a questionnaire. The study were mainly targeting enterprises and individuals. In addition, all the previous studies have used the SPSS as a tool for data analysis. Figure 4 shows that sample size of selected studies. It shows that on average, the sample ranged between 200 to 2000 respondents with mean of 274.

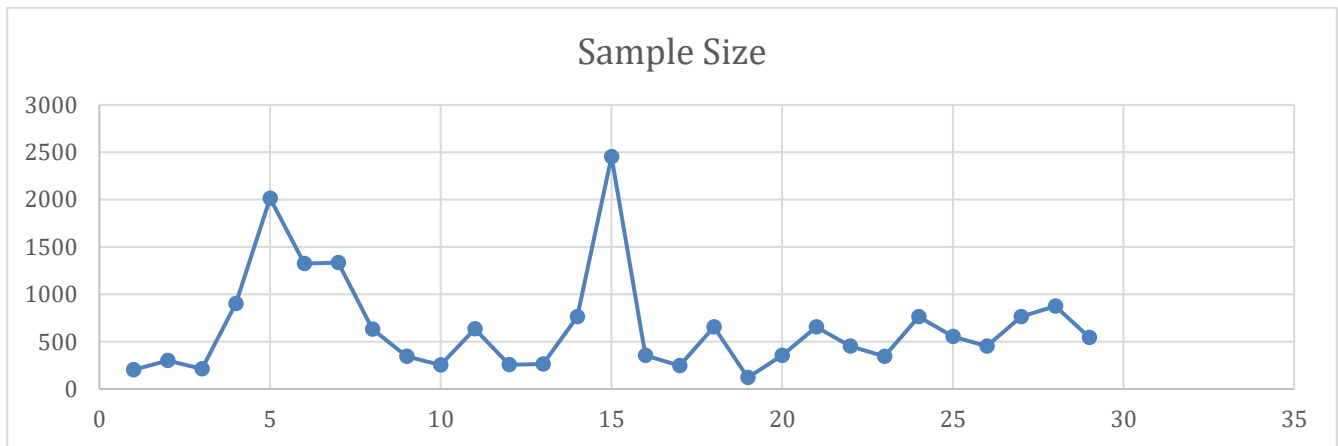


Figure 4: Sample Size

Methods

The majority of the previous studies that has been reviewed in this study were quantitative. Among the quantitative, 4 studies have used a secondary data approach while 25 studies deployed a primary data approach. Figure 5 shows the approaches of the reviewed studies.

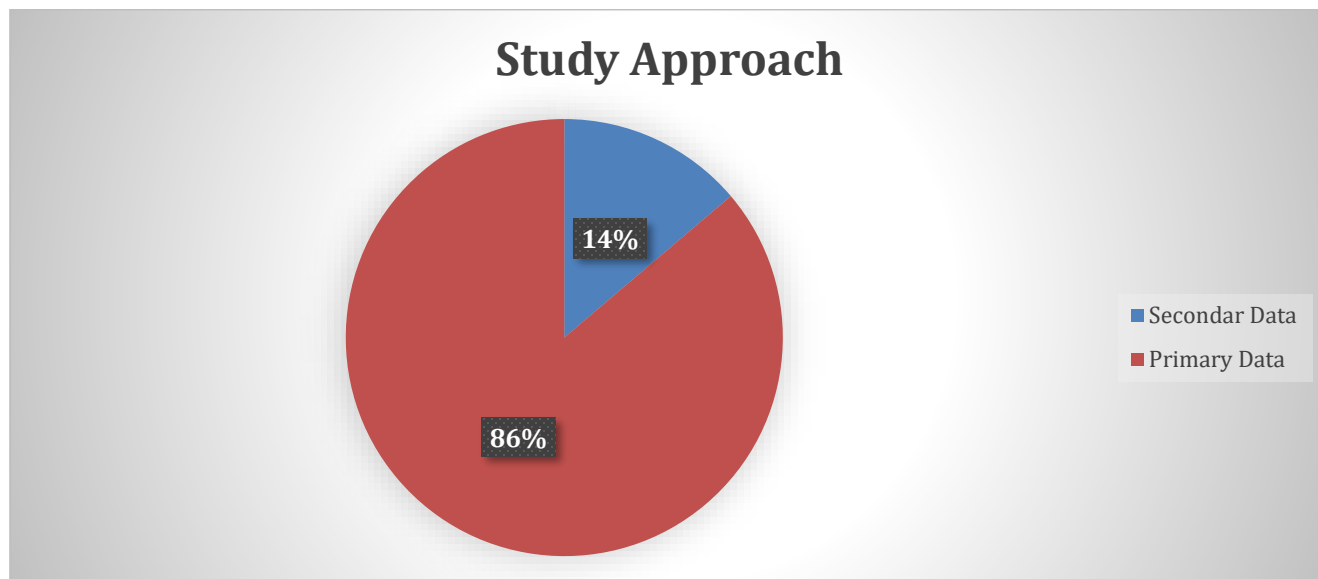


Figure 5: Study Approach

Effect of Compliance Cost on Taxpayers Compliance

Findings from previous studies indicated that the effect of compliance cost on taxpayers' compliance is negative. In other words, the increase in compliance cost reduce the tax compliance behavior among the respondents. The effect is more severe among SMEs where the cost of compliance discourage the SMEs to comply with the tax law. More than 50% of the studies compared the effect of tax compliance among SMEs and large enterprise and their findings suggest that SMEs bearing less cost. However, in comparison to their revenue, the percentage is higher than the large enterprise.

Limitation and Direction for Future work

This study is a review study that aims to examine the related literature to identify the effect of tax compliance cost on taxpayers' compliance. The study reviewed 29 articles. Thus, the findings are limited to these articles. In addition, the study focused on the tax compliance cost. Accordingly, the finding is limited in this regard. As a way forward to enhance the generalizability of this study, future studies are recommended to enlarge the scope so that more articles can be included and this will increase the ability to generalize the findings of this study. Future studies are also recommended to examine particularly the type of cost and focus either on internal cost or external cost.

The future studies also are advised to focus on individual tax compliance cost. Majority of reviewed articles focused on the SMEs and enterprise while few have examined the individual. Further, the future studies are recommended to deploy statistical tools such as partial least square and AMOS to examine existing theories related to tax compliance cost. Lastly, future studies are recommended to conduct more studies in developing countries. Findings of this study suggested that more than 90% of previous studies

were conducted either on developed countries or emerging economies while studies pertaining to developing countries are limited in this topic.

Conclusion

This study was conducted to review the articles related to tax compliance cost and its relationship with the taxpayers' compliance. The related databases were searched to find articles related to the topic. After three screenings, the related articles were reviewed, analyzed, and findings were presented using frequency analysis. The findings indicate that there are two types of compliance cost. The first is internal while the second is external. In value, the external is higher than the internal. The findings also showed that most of previous studies have examined the issue of tax compliance among enterprises such as SMEs and large enterprises. In addition, studies in developed countries and emerging economies far outperform the studies in developing countries. Sample size of the reviewed studies is considered large and the effect of tax compliance cost is more severe and large for the SMEs compared with large enterprise.

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