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Determinants of Tax Compliance: a Systematic Review

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Abstract: This paper has investigated the empirical research by exploring the factors of compliance decision. Tax compliance is important for governments since tax is the essential source of their revenue in developing as well as developed countries. Nowadays the roles of governments have been increasing and because of this they must have to collect more tax revenues. But, they can't do this because of tax non compliance. Literatures have indicated that the tax compliance decision of taxpayers will be affected by a number of factors like penalty, tax system fairness, tax rate, probability of detection and being audited, etc. Itargues that the tax authorities shall have to keep the tax system to be fair, maintain appropriate levels of penalty, rather than merely relying on carrot and stick approach the government and the tax administrative body should excel on responsible citizens' approach.

Keywords: Fairness of the Tax System**,** Probability of Being Audited, Tax Compliance, Tax Rate

1. Introduction

Tax is a compulsoryfinancial obligation imposed by the government without any expectation of quid pro quo or tax is a mandatory payment by the people for which there is no direct return to the taxpayers. Tax imposes a personal obligation which cannot be escaped on the people to pay the tax if they are liable to pay it. Taxpayers should pay according to their ability and the people in the same financial position should be taxed in the same way [1].

Governments levy taxes for a number of purposes and hence the major is for raising funds to cover public expenditures and the other will beforproper allocation of resources. Majority of government's revenue comes from taxes paid by taxpayers. The existence of consumption of public goods and services necessitates putting some of our income into government hands. Government intervention in the supply of public goods is unavoidable and can only be done if the public pays taxes for the production and supply of such goods [2].

Tax compliance is the acting of taxpayers in accordance with the tax laws and proclamations of the country. It can beappropriate reporting of income or tax base, computing the tax liability in the correct manner, filing of returns and payment of the tax liability on time. Tax compliance can be described as the degree to which a taxpayer compels to tax rules and regulations. On the other hand, non compliance can be defined as failure of individuals to act according to their tax obligation. It can be not reporting the true tax bases, not filing and paying on time, and incorrect calculation of tax liability [3].

Tax compliance is taxpayer's compliance with reporting requirements like, timely filing of returns and reporting accurate tax liability with regard to regulations and court decisions applicable at the time return filing. This definition assumes that in order to comply with the tax law, one must declare the correct amount of income, expenses to which one is entitled and subsequently pay the correct amount of tax by the due date [4].

These days government's role has being increasing and government must have to collect more tax revenue to finance its operation. But governments are confronting trouble in collecting the tax they need because of many reasons. The main reason is tax noncompliance [5]. It is argued that tax non compliance which is a growing and continualuniversalproblemwhich needs to be readily addressed [6].

2. Methodology

The factors that have an effect on tax compliance behavior of taxpayer's has been studied by a number of studies conducted by adopting different research methods analytical methods. For example, [7], has conducted a study entitled with determinants of tax compliance case of Gondar city, Ethiopia by using ordered logistic regression model. Furthermore, the relationship between tax knowledge, penalties and tax compliance was examined by using multiple linear regression analysis [8]. Another study [2] used pearson correlation coefficient and chi square test in order to investigate the relationship between tax compliance and its factors. However, the determinants of tax compliance were examined by adopting ordered probit model [9]. Additionally, the determinants of tax compliance behavior was examined by using one way ANOVA, two samples and one sample T-test [10].

This paper is based on a review of the findings of previous studies conducted related to determinants of tax compliance. In analyzing the findings of the reviewed studies, an approach which is called metaanalysis was adopted. The papers to be included in this study are selected based on the following criteria.

a. Studies that examine the tax compliance factors

b. Studies conducted by using tax compliance as a dependent variable and

c. Studies those are empirical.

3. Tax Compliance

There is no universally accepted single definition given to the term tax compliance. For instance, it has been defined as compliance or acting in accordance with reporting requirements of the country which means that taxpayers file all required tax returns on time and the returns should report the correct amount of tax liability in accordance with the internal revenue code, regulations and court decisions applicable at the time the return is filed [4]. On other hand, tax compliance can be defined in terms of tax gap. Tax gap is the difference between true individual income tax liability and that finally collected on a voluntary basis or by enforcement action [11].

Generally, compliance can be understood as acting as per the law and non compliance is deviation from the law. Based on the above expressions tax compliance can be shortly refined as the desire or willingness of the taxpayers to act in accordance with the tax law and the voluntary effort they exercise to pay their tax liability on timely basis.

Tax noncompliance is unable to meet tax obligations whether intentionally or unintentionally [11]. Tax evasion involves some elements of fraudulent behavior accompanied by a real intention on the part of the taxpayer to intentionally mislead, deceive or conceal from IRB to pay less tax than actually owed [12]. In general, non compliance may take several forms including:

a). Failure to submit a tax return within the stipulated period or non submission;

b). Understatement of income;

c). Overstatement of deductions; and

d). Failure to pay assessed taxes by the due date.

3.1. Tax Compliance Theories

Several theories of behavior which are borrowed from economics and the psychological sciences that can be very useful in classifying the variables in analyzing tax compliance behaviors [13]. These theories include:

1. Allingham and Sandmo (1972) Model,
2. Institutional Anomie Theory, and
3. The Theory of Planned Behavior.

3.1.1. Allingham and Sandmo Model (1972)

Tax compliance economic model which was a base for a number of literatures was developed [14]. In this model, the taxpayer is assumed to have an income (I) and have to choose the amount to declare to the tax agency and this declared income (D) is subject to tax rate (t); and on the other hand the income that is not declared is not subject to tax. But, the taxpayer will face a probability of detection (p) at which a fine (f) will be imposed upon him for non compliance. Thus the taxpayer has the choice between:

1). declare his true income or

2). Not declaring his true income.

The choice of the laterstrategy will depend on whether or not he is subject to investigation by the tax authority. If he is not investigated, he is clearly in a fortunate condition than under choice one. If he is inquired, he is not better off as the audit may lead to penalties. Thus the taxpayer chooses to declare hid true income (D) to maximize the expected utility of the evasion gamble.

This model suggests that Dis a function ofIncome, probability of detection, fines & tax rate which shows that declared income (D) directly related with income, the probability of detection and the fine rate and inversely related with the tax rate.

$$D = f\ (I, p, f, t)$$

However, there are other factors that affect compliance decision; while government takes away, it also gives back and this surely exerts influence on compliance or non compliance. The declared income (D) may be modified to reflect individual's receipt of government expenditures (G) as follows:

$$D = f\ (I, p, f, t, G)$$

Thus compliance decision is also directly related with individual's perception of expected benefits from social goods and services funded by their tax payments.

3.1.2. Institutional Anomie Theory

According to institutional anomie theory, the decision of individuals is based upon social values that may be individually in conflict of each other and together balance eachother in producing behavior. when individuals have different sets of values which are imbalanced and the decisions that they made based on these values may have different behaviors like crime [15]. Nowadays, institutional anomie theory has been appearing to be applicable in order to examine the relationship that exists between cultural values and non compliance behaviors. Institutional Anomie Theory is based on four theories derived from sets of national cultural dimensions likely increase no compliance behaviorwhich include individualism, achievement orientation, assertiveness and humane orientation [16].

Individual cultural values are the bases for behaviors that emphasize on the pursuit of firm self interest, largely neglecting concern for ethical consequences. According to Institutional Anomie Theory, individualistic cultural values encourage firm's decision makers to choose goal achievement beyond concerns for the ethical or legal means to achieve goals [17]. Thus, in such societies, firms more willingly deviate from accepted norms and evade taxes. On the contrary, collectivist cultures favor allegiance to the greater collective rooted in the notion that societal members are interdependent [18] and, as such, should deter individual gains at the expense of the collective. This suggests that individualistic cultural values should inflate temptations for firms to evade taxes.

3.1.3. Theory of Planned Behavior

As an extension of the theory of reasoned action, the theory of planned behavior was proposed [19]. The theory of reasoned action had been proposed [20]. According to the theory of reasoned action, people are more likely to do a behavior if they evaluate the suggested behavior as having positive results (attitude). A high correlation of attitudes and subjective norms to behavior has been confirmed in many studies. However, the same authors have raised a counterargument against the high relationship between attitude, subjective norms and behavior. They argued that because of circumstantial limitations, attitude and subjective norms do not always lead to behavior. To improve on the predictive power of the theory of reasoned action they added a new component "perceived behavioral control" to help account for behaviors that arise where an individual's control over the behavior is incomplete. By this, he extended the Theory of reasoned action to include the role of non-volition in predicting behavior. The extended version is called the theory of planned behavior.

Behavioral, Normative and Control beliefs: In addition, the three predictors are determined as follows: Attitude is a function of behavioral belief or salient information, which is the perceived likelihood that performing the particular behavior will lead to certain consequences, weighted by the extent to which these consequences are valued. Subjective norm is a function of normative belief which is the perceived pressure from specified referents to perform the target behavior, weighted by the motivation to comply with the people one cares about. Perceived behavioral control is determined by control belief which is the perceived access to the necessary resources and opportunities to perform a behavior successfully, weighted by the perceived power or effect of the particular control factor.

Intention and Behavior: Intention is the cognitive representation of a person's readiness to perform a given behavior and is considered to be the immediate antecedent of behavior. Behavior is the translation of intention to action.

The main hypothesis of the theory of planned behavior is that there is one immediate determinant of behavior, namely the person's intention to perform or not perform it. This intention is itself in turn viewed as determined by three things: attitude, subjective norms and subjective control toward the specific behavior. More specifically, the theory of planned behavior attempts to provide an account of the way in which attitude, subjective norms, subjective control and intentions combine to predict behavior.

3.2. Determinants of Tax Compliance

taxpayers are influenced by many factors from compiling their tax obligation including, their distortion toward public institution, perceived fairness of taxes, prevailing social norm and chance of noncompliance being detected and punished [5]. On the other hand, tax compliance can be affected by many factors such as magnitude of compliance cost, the extent of penalty, perceived fairness of the tax system, awareness level of taxpayers and perceptions of government spending [21].

3.2.1. Effect of Referrals

Peer influence usually comes from friends, relatives, colleagues and business acquaintances. Doings and acts of close friends or relatives have no relationship with the tax compliance behavior of taxpayers in Mauritius [22]. But, non-compliance behaviors of others have an effect on the decision of tax payers whether to comply or not in East Gojjam-Ethiopia [2]. Additionally, the compliance behavior of taxpayers in Bahir Dar is significantly influenced by the non compliance of others (effect of referrals) [10]. Similarly, the influences of the referent groups have a positive and significant impact on tax compliance [23]. Accordingly, this implies that if a taxpayer refers to a compliant taxpayer, then the tendency to comply with the tax laws of the country is higher and if a taxpayer refers to a noncompliant taxpayer, the tendency to commit tax avoision is higher as well. On the other hand, the effect of referent groups was not an important factor in determining the compliance behavior of taxpayers in small and medium enterprises of Indonesia [24]. Consistent with this result the effect of referent group was not an important factor that determines tax compliance behavior in Mekele city, Ethiopia [9].

3.2.2. Tax Rate

A number of studies have been carried out to determine the impact of tax rate on tax compliance. Tax rate has a significant and negative effect on the tax compliance in Africa which implies that tax systems are complied by taxpayers when there is low tax rates and vice versa [25]. Similarly, tax rate is found to be significantly and negatively affects the compliance behavior and decision of taxpayers in Bahir Dar, Ethiopia [7]. Tax rate has a positive relationship with tax non compliance but it has a negative correlation with tax compliance which implies that higher tax rates motivate taxpayers to engage in tax fraud [26]. Similarly higher tax rates are the problems for tax compliance in Yemen [27]. In contrary to this, a study conducted in Indonesia has reported that tax rate has nothing to do with tax compliance decision of taxpayers [24]. Similarly, tax rate has no significant role in explaining tax compliance behavior of taxpayers in Malaysia [28].

3.2.3. Penalty

Tax penalty is a punitive measure that the tax law imposes for the act of non compliance [29]. Empirically, penalty has positive and significant effect on tax compliance decision which indicates that this association between penalty and tax compliance is towards the argument that severe penalties and sanctions used to achieve greater compliance level and curbs future actions of tax evaders. This means that as the severity of penalties increases, the tax compliance level of taxpayers will also increase and vice versa [7]. Penalty has significant indirect impact on tax compliance in Nigeria which implies that high level of penalty will have to decrease the tendency to act in accordance with the tax laws and regulations of the country [30]. Additionally, penalty is an important factor which plays a significant role in influencing the compliance behavior of Malaysian small and medium enterprises. Penalty was found to have a positive significant role in determining the value added tax compliance attitude [32]. In contrary to this [9], have found that compliance decision of taxpayers in Mekelle city, Ethiopia is not affected by penalty. In line to this there is an argument that penalty does not play an important role in determining the compliance behavior of taxpayers in Nigeria [8]. Surprisingly, there is a study that founds penalty is positively related to non compliance and negatively related to tax compliance [26].

3.2.4. Probability of Being Audited

Studies have been conducted in different areas of the world to determine the effect of probability of being audited on the compliance decision of taxpayers. Accordingly the results of these studies are different from each other. For example, compliance behavior and decision of taxpayers is significantly and positively influenced by the probability of being audited which indicates that compliance of taxpayers could be encouraged by high probability of being audited in Jimma zone, Ethiopia [5]. Similarly, tax audit has a positive significant effect on the compliance decision and behavior of taxpayers indicating that as the probability of being audited is high, the level of compliance will rise [30]. Surprisingly probability of being audited has negative significant impact on tax compliance [23]. According to this finding, higher possibility of tax audit would potentially discourage the compliance decision of taxpayers in southern nations, nationalities and people's regional state, Ethiopia. Additionally, probability of being audited has a statistically significant positive role in explaining the compliance attitude of taxpayers in Bahir Dar city, Ethiopia [32]. Moreover, probability of being audited was not an important factor in determining the compliance behavior and decision of taxpayers in their studies [2, 10]. Similarly, probability of being audited has not an impact on the level of tax compliance [33].

3.2.5. Fairness of the Tax System

Fairness of a tax system is about a concept which is related with having equitable tax system. In equity we mean that the principle that taxes should be fair and should be based on different people's ability to pay, which is usually related to their income [7]. Tax compliance and tax fairness are directly related and this relationship is expressed that the compliance behavior of taxpayer's will decline if they percept that they are paying higher than other taxpayers having the same amount of income [23]. Accordingly, tax system's fairness has a negative impact on tax non compliance and a positive relationship with tax compliance behavior [26]. Tax law fairness has found to be having an important impact on tax non compliance behavior [28].

3.3. Importance of Understanding Tax Compliance

Over the last three decades a number of studies have been conducted in the area of tax compliance and from which two important findings has developed. At first, tax non compliance is a consistently growing global issue which needs to be readily addressed. Secondly, there is no a great deal of agreement about why people comply or do not comply with their tax obligations. In any case, strategies to enhance compliance need to be implanted in sound theory, and thus an understanding of tax compliance literatures plays an important role for the tax authority which demands for improving efficiency of tax collections [6].

Various countries have been moving towards a further developed in order to increase tax compliance. With the combination of taxpayers' assistance and enforcement program, tax compliance level is expected to be increasing. Any way there happens to have been a move in attitudes towards treating the taxpayer less as a passive donor who simply required paying for their tax liabilities and more as a customer sometimes needing explicit types of help and support.

When compliance is not accomplished on a voluntary premise, revenue authorities must recognize and address the risk associated with non-compliance by creating procedures focused at those dangers. Voluntary tax compliance will be enhanced when tax authorities have an understanding of major developments and trends in tax compliance [34]. The choice between compliance and non compliance may only be a matter of opportunity, convenience, or even interpretation of the law [35]. Taxation is explained as phenomenon which cannot be avoided in any economy as far as services and other roles are expected from governments [36]. Inspite of the way that the historical background of tax collection is as old as that of states or governments, still there are holes in each country, particularly underdeveloped country like Ethiopia to the extent voluntary compliance is concerned. Tax is perceived by taxpayers as evils that cannot be escaped and when dealing with tax system efficiency and effectiveness, the issue of tax compliance is a central premise. Many researchers have discussed about factors that will have an impact on voluntary compliance and how voluntary tax compliance is related with social, cultural, political, legal and administrative aspects. Legal enforcement with the help of penalties and sanctions exist in the tax laws of nations in the world with in different degree. Regardless of the application of these legal enforcements, there are still gaps in tax compliance which can be clearly understood that tax compliance cannot be enhanced by mere application of legal enforcement. Even though the existence of penalties and sanctions cannot be undermined when dealing with tax compliance, focusing on positive side i.e. encouraging voluntary compliance is by far rewarding as far as long lasting and consistent advantage is concerned. Therefore, understanding of tax compliance that is why people tend to comply and why they tend to evade gives a clear road map to the solution of this exceptionally established issue [36].

3.4. Approaches to Improve Tax Compliance

Tax compliance enhancement requires long term change endeavors which begin with capacity building of tax authorities and carrying out effective and efficient collection systems. Reform of the legal framework and judiciary is also often required in order to ensure that the necessary powers, penalty regimes and dispute resolution processes are in place [37].

Tax compliance improving reform priorities are different from country to country and across regions which reflects varieties in phases of growth, capacity of the administrative body and the degree of tax non compliance. In return this implies that reforms need to be fitted to each of the country's compliance conditions. The relative higher level of tax non compliance and low level of revenue of developing countries generally suggest that potential existence for bigger revenue from compliance improvement initiatives. More advanced and sophisticated approaches to compliance management can be taken in developed economies.

There are two main approaches that will ensure tax compliance which are the carrot and stick approach and the responsible citizen's approach [38].

3.4.1. Carrot and Stick Approach

This approach is based on a relatively narrow interrelationship of economic rationality. According to this approach, totally immoral individuals maximize their utility by maximizing their income and wealth andtaxpayers will evade if they consider that by doing so they can minimize their tax burden. Noncompliance can be explained by factors such as tax rate, the probability of to be detected while evading, penalties and the degree of risk aversion [38].

3.4.2. Responsible Citizens Approach

Regarding the responsible citizen's approach, there is an extension of discussion that disciplines other than economics have suggested important factors that affect taxpayers' compliance behavior. Sociology has offered a number of factors like social support, social influence, attitudes and certain background characteristics such as age, gender, race and culture. Psychology reinforces this approach and has even created its own branch of 'fiscal psychology' and the contribution includes the indication that attitudes towards the state, the revenue authorities are as important factors as perceptions of equity [38].

4. Conclusion

It is obvious that taxes are the most important source of revenue for governments of both developing and developed countries. Among other things, the amount of revenue generated from taxes depends on the tax compliance level within the country. Tax compliance is the act of taxpayers with regard to the tax laws and the reverse is true for tax non compliance in which it refers to deviations from the tax laws and regulations of the country. Tax noncompliance is socially harmful, as it can reduce revenue, distort labor market and weaken state stability by enriching perception of cheating and fraud. The reasons for non compliance should be known in advance in order to be effective in reducing tax non compliance (increasing the level of compliance). This paper has tried to discuss previous researches which are related to factors that might have an impact on tax compliance. The findings of many studies have suggested that tax system fairness, tax rate, effect of referrals, penalty and probability of being audited can affect the compliance decision of taxpayers.

Any methodology to minimize tax non compliance should start with a theory of why taxpayers evade taxes. Economists approach the question of why people comply with the tax laws begin by constructing a theory based upon the assumption about human conduct that underlies all of economics (act rationally in evaluating the cost and benefits of any chosen activity).

Psychologists tend to acknowledge that individuals are moral creatures with thoughts and values of their own and that commands and their own driving forces filter through and are impacted by this ethical screen. They would take note of factors like, the probability of detection, fines and penalties, etc. are intervened through individual attitudes and perceptions.

On the other hand, sociologists in general analyze the purpose behind assortment in human conduct in the structure of the social framework. It is rationale to accept that human conduct in the area of whether or not to comply with the tax laws is affected by social interactions which similarly as other forms of behavior. Compliance behavior and attitudes towards the tax system may be affected by the behavior of an individual's reference group like relatives, neighbors, friends and political associates.

Generally, tax compliance theories are sorted out around the premises of economic, psychological and sociological theories. The tax compliance factors radiate from these theories in a single manner or the other so in which these theories are always a base in understanding tax compliance decision and behavior.

Tax compliance will be enhanced with the voluntary collaboration of the taxpayers with the tax authority an administration. Just mere dependency on carrot and stick approach will have no sweeping outcome. Consequently, the tax authority and the government should have to excel on responsible citizens' approach in their effort to increase the level of compliance. Tax non-compliance is unavoidable in each general public or country. In this manner, it is advantageous to recommend that the above methodology must be bolstered by lawful enforcement and the endeavors must have to supplement each other.

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