

Attitudes and Tax Compliance: The Role of Tax Knowledge and Education

(Sikap dan Pematuhan Cukai: Peranan Pengetahuan Cukai dan Pendidikan)

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ABSTRACT

Tax knowledge and education among taxpayers are vital and very important in any countries. Lacking of knowledge and education will diminish tax collection that would have been used for the nation's economic and social planning. This paper attempts to highlights the importance of tax knowledge and education in our daily routines. Tax knowledge was found to moderate the relationship between attitude and compliance under reporting scenario. However, findings failed to support the moderating effect of tax knowledge on the relationship between attitude and compliance under filing scenario.

Key Words: Attitudes, Tax Knowledge, Compliance Behaviour

ABSTRAK

Pengetahuan dalam ilmu percukaian di kalangan pembayar cukai adalah penting bagi sesebuah negara. Pengetahuan yang cetek di kalangan penduduk akan menjejaskan hasil kutipan cukai bagi membiayai pembangunan ekonomi dan sosial. Kajian ini cuba menonjolkan betapa pentingnya pengetahuan dan pendidikan ilmu percukaian dalam rutin harian kita. Hasil kajian mendapati pengetahuan cukai berperanan sebagai pembolehubah penyederhana dalam hubungan antara sikap dan pematuhan di bawah senario pematuhan laporan. Namun, dapatan kajian gagal untuk menyokong pembolehubah penyederhana di bawah senario pematuhan pemfailan.

Kata kunci: Sikap, Pengetahuan Cukai, Pematuhan Tingkahlaku

INTRODUCTION

Prior studies have documented that taxpayer compliance decisions are influenced by many social psychological factors (Bobek, Hageman, & Kelliher, 2011; Morse et al. 2009; Randlane, 2012). People's attitude toward behaviour has been shown to be one of the most relevant socio-psychological factors of tax compliance (Murphy, 2004; Kirchler, Hoelzl, & Wahl, 2008; Randlane, 2012). The importance of attitudes in determining tax compliance is evident in a review of Cullis and Lewis (1997). In their study, the authors conclude that the values, attitudes, perceptions and morals of the taxpayers are of paramount importance. They particularly state that tax compliance will be relatively high when attitudes towards compliance are favourable. This is consistent with Hanno and Violette (1996) who empirically establish the positive link between attitude toward tax compliance and compliance behaviour. In Malaysia, Loo, Mckerchar, & Hansford (2009) found that taxpayers with favourable attitudes would be more compliant. In other words, people do willingly to comply with their tax obligations may be positively related to their attitudes about taxes.

Research has identified there are certain components that forming taxpayers' attitude such as social norms, tax morale, patriotism, guilt and shame that are considered to have significant influence on tax compliance behaviour (Hanno & Violette, 1996; Kirchler, 2007; Kornhauser, 2007; and Torgler, 2007). While those components are undeniably important, this present study is however, interested on focusing on emotional components of attitudes such as sense of civic duty, feelings of guilt, and feelings of shame for failure to comply with the requirement of tax law. In other words, all these emotions elements would be the motivational forces in deterring taxpayer engaging in tax evasion.

In the context of tax compliance studies, Torgler (2007) argued that person who chooses to evade taxes may feels guilty of not paying or less paying income tax if the obligation of paying taxes is an accepted social norm. They may feel worried about getting caught and feel ashamed if all underreported income is discovered by tax authority. In fact, there is some evidence that feelings of shame and guilt over wrongdoing may influence taxpayers' reporting decision (Alm & Torgler, 2011). Erard & Feinstein (1994) based on psychological theories incorporate the role of guilt and shame in tax compliance behaviour. Nevertheless, Erard and Feinstein's approach concluded that the taxpayer will not experience the threat of embarrassment if the people whose opinions are most valued do not discover his crime.

Ahmad & Braithwaite (2005a) also have found that feeling of guilt and shame may have been the driving mechanisms in predicting whether a person will or will not comply with their obligations. In a recent study of Coricelli, Joffily, Montmarquette, & Villeval (2010) investigated the role of emotions and tax evasions, stated that people may feel anxiety not only because of possible punishment for illegal behaviour but also as a matter of moral implications associated with the risk of a public exposure of their behaviour. In other words, they may feel regret and shame if their cheating behaviour is publicly revealed. This might have a significant impact on efforts to improve compliance and reduce the proportion of evaded income. Coricelli, Joffily, Montmarquette, & Villeval (2010) further suggested that a tax authority should capture moral emotional in order to encourage more tax compliance from individuals.

In addition, they may feel good about themselves for doing the right thing and served their country and communities (Calvet & Alm, 2014). They are able to file successfully an appropriate tax return and pay the correct amount of taxes. Torgler (2004) also found that the extent of happiness may influence the moral attitudes towards tax compliance and thus increase taxpayers' willingness to pay taxes honestly. In some cases, however, some taxpayers may feel good and gets mental and financial peace even though they are doing something wrong. If taxpayers think that evading taxes is not wrong as it does not really hurt anyone, he or she may not comply with tax laws. In other words, they do not feel remorse for avoiding their tax obligations and will never find themselves at fault (Murphy, 2004a). In fact, they blame someone else for what has happened to them. Thus, it is clear that all these feelings, thoughts and beliefs can have a strong influence in forming taxpayer attitudes towards tax compliance.

Apart from that, attitude that based on sense of civic duty is also relevant and important in explaining tax compliance behaviour. Civic duty refers to a belief that an individual has an obligation to undertake actions that benefit others even when the actions are costly to themselves. The question of why some people pay taxes while others do not can be explained, or at least in part by recognizing a person's sense of civic duty. Some suggest that an individual will comply with their tax obligation not merely because they are concerned with the threat of punishment or fears of being under the "radar screen" of tax administration, but because they have a sense of civic duty (Bergman & Nevarez, 2006). Some researchers have shown that the sense of civic duty has a powerful predictor of how likely an individual's reaction to tax issues (Torgler, 2007; Hofmann et al. 2008).

Kornhauser (2007) claimed that people with a high sense of obligation to comply with tax laws will see paying taxes as a gain, not as a loss of personal income. They believed that the

government will act in their interest and provide numerous vital benefits for society. When they believed that the tax system is fair, an individual with a strong sense of civic duty are therefore tend to be compliant and willing to cooperate with tax authority. They have an “intrinsic motivation” to comply with such obligation even if the system provides opportunities for noncompliance (Alm, Kirchler, & Muehlbacher, 2012).

The concept of civic duty is also supported by the work of Orviska & Hudson's (2002). They believed that people may comply with the law because they feel that the legal authorities have the right to dictate behaviour. However, civic responsibilities have a close relation with voluntary work and it's really good because it makes an individual feel better for giving back to the society. In brief, the results provide evidence that both civic duty and law abidance have a significant impact on the decision to evade taxes via attitudes to tax evasion. In other words, senses of civic duty are the motivational forces in deterring taxpayer engaging in tax evasion. People could avoid all tax, but the concept of civic duty suggest that people would still choose to pay tax because they feels bonded to and concerned about the welfare and rights of others in one's community.

In summary, the inclusion of noneconomic factors such as attitude may be a significant factor in the analysis of tax compliance. To a certain extent, according to Rhodes & Courneya (2003) attitudes are more important than opportunities in determining taxpayers' behaviour. Therefore, policy makers need to address the emotional components and opinions about government or the tax system to better understand the general framework of attitudes in tax compliance.

ROLE OF TAX KNOWLEDGE AND EDUCATION

One of the underlying assumptions about the link between attitudes and behaviour is the principle of consistency. It is usually assumed that the behaviour of a person tend to be consistent with the attitudes that they hold. Therefore, if we knew someone's attitude, then we could predict about how that individual will behave. As mentioned before, attitudes have an impact on the decision we make. These attitudes affect how people feel about certain issues, which in turn may govern their behaviour. However, in some cases people do not always follow what they believe, but behave differently. For instance, in a tax context people may have a positive feeling towards paying taxes, but were much more likely to support for tax evasion. Thus, the difference between what we say and what we do may raise some questions about the relationship between attitude and behaviour. It is apparent that there are factors that intervene between attitude and behaviour which cause a person's behaviour to be inconsistent with his or her attitudes.

In taxation context, attitude toward tax compliance may be influenced by various factors for example fairness perceptions of the tax system ((Kirchler, 2007, Devos, 2009; Feld & Frey, 2007), taxpayers' understanding of a tax law (Palil and Lymer, 2009), tax education (Mat Bahari & Lai, 2009;), demographic factors (Ross & Mcgee, 2012) and many others. While the contributions of those factors are generally acknowledged, the present study however, focuses solely on one main behavioural factor that have been identified as universal importance for sole proprietors namely tax knowledge requirements.

Prior studies of small business have shown that lack of tax knowledge are major contributors to unintentional non compliance. They were also shown to have less tax knowledge than employed persons, thus felt less competent in filing their tax returns (Kamleitner et al. 2012; Loo, Mckerchar, & Hansford, 2009). It was found that, they were not able to compute tax liability and even not aware of the existence of the relevant incentives and exemptions that the government has provided to reduce their tax burden (Lai & Zainal Arifin, 2011; Loo et al. 2010). When they feel unqualified to file their tax appropriately, a majority seeks advice from tax practitioner to deal with their tax matters (Kirchler, 2007).

Tax laws are too complex to be understood by laymen and its changes make it difficult not only for tax officers, tax academics, tax practitioners to keep abreast of the latest development, but to ordinary people like the sole proprietors (Choong, Wong, & Khin, 2011). Essentially, tax law imposes two separate obligations on sole proprietor namely submitting tax return and the payments of tax liabilities. In order to meet both obligations there is a need keep records and documents in relation to their business operations. They also need to analyze how certain transactions should be treated for tax purposes and struggle to properly calculate their tax liability. These obligations may seem quite complicated and complex for the small business owners who cannot afford to hire a tax agent. Even for those having their taxes prepared by tax agent, they may not fully understand what they are actually looking at.

Since tax laws are criticised for being too complex, it can be expected that the level of tax knowledge is considered relatively low (Kirchler, 2007). In order to enhance taxpayers' ability to understand the tax laws and to take advantage of these tax incentives and exemptions, previous studies have documented that tax knowledge plays a strong role in forming an individual's attitude and consequently improve compliance (Eriksen & Fallan, 1996; Palil & Mustapha, 2011). According to Loo et al. (2010), when a taxpayer has good knowledge on taxes, it may somehow improve taxpayer's positive attitudes towards tax laws. These improvements are expected to encourage the willingness of taxpayer to comply with tax obligations. Barjoyai (1992) also emphasized the importance of tax knowledge as the most essential factor that can influence peoples' attitudes towards taxation and tax compliance behaviors. It is probably more important than knowledge of geography or geometry. Barjoyai further suggested that all future taxpayers need to be equipped with sufficient tax knowledge at schools or tertiary levels as taxation is a universal knowledge and needed by each citizen with potential liability of paying tax one day.

Several researchers have reported that greater awareness and additional knowledge on tax matters has a positive influence on attitudes towards tax compliance. For example, in a study by Eriksen and Fallan (1996) reports significant changes in respondents attitude toward tax due to the increased in specific tax knowledge. They presumed both the information about tax rules and the financial knowledge as in order to calculate economic consequences for taxpayers. After taking part in a course on taxes, respondents more severely judged tax evasion and perceived tax system as fairer. It shows that tax knowledge is one of the best devices to reduce the tax evasion among taxpayers, given that as the level of tax knowledge increases. Another related study by Fallan (1999) confirmed that a better knowledge of tax law would improve taxpayer attitudes and consequently have an impact on tax compliance behaviour. A central issue was whether knowledge related to taxation would influences the attitudes of male and female tax law students differently. In that

experimental study, Fallan (1999) focused on technical knowledge of tax concerning tax allowances and tax liabilities. The author found that better understanding of the tax system would significantly change both male and females' attitudes towards the fairness of tax system. After increasing their tax knowledge, they considered the tax system to be fairer than they did before. Having demonstrated the importance of tax knowledge in shaping tax compliance behaviour, the following hypotheses are proposed:

H₁: Tax knowledge and education moderates the relationship between attitude and intention to comply with tax obligations (reporting compliance)

H₂: Tax knowledge education moderates the relationship between attitude and intention to comply with tax obligations (filing compliance)

METHODOLOGY

Sample and Data

The sample of this study would be small business taxpayers who operate business, located on the both sides of the North-South Expressway. Based on the data released by Malaysian Highway Authority, there are 24 Rest and Service areas (inclusive of four overhead bridge restaurants) and 45 lay-bys on all PLUS-operated highways for the convenience of the travelling public. Fourteen locations of rest areas have been chosen to be included in the survey. The survey questionnaire was handed directly to the target respondents. An estimated of 276 stall operators were expected to be included in this study. However, the actual numbers of stall operators present were only 245 people. The data collection process took approximately five months to complete, commencing in April 2014 and ending in early August 2014.

Instrument

The questionnaire survey consists of four sections namely Section A, Section B, Section C and Section D. Section A and Section B were designed to measure the behavioural dimension of respondents. Section C was designed to measure the amount of tax knowledge where the respondents were tested on some of the basic tax knowledge. Finally, Section D contained questions on the respondents' profile such as age, gender, education and experience. All instruments were adapted from various literatures with minor wording modifications to fit the study context.

In this study, compliance behaviour was measured through its proxy, intention to comply. Due to the lack of access to IRB data, it was not possible to measure the actual tax behaviour of the respondent. As such, this study developed two different tax compliance scenarios that are relevant to their business activities in explaining tax compliance behaviour. Each scenarios contain a brief descriptions of a real life tax compliance situation which requires respondents to respond how they might react in a given circumstances.

In the first scenario, respondents were asked whether they would report the cash income on their tax return if they were in similar situation as stated in the scenario. The second scenario requires the respondent to determine whether they would file a tax return if they were in similar situation faced by a hypothetical person. In order to increase the validity and reliability of the scenarios, a discussion has taken place between the researcher and tax officer of IRBM. They were asked whether or not the scenarios presented reflect the reality and the most frequent tax scenarios that they faced.

In order to assess attitude toward compliance behaviour, a few statements were provided where the respondents were asked to indicate how they feel about the compliant course of action as described in the scenario. An attitude which relates to emotional elements such as guilty, sense of civic duty is measured with six items. For instance, in the reporting compliance scenario, respondents were asked whether they feel pleased of guilty if they omit the cash sale from the tax computation. These statements were adapted from previous research by Ajzen (2002) and Saad (2009) with some minor modifications.

The level of tax knowledge was measured based on the total score of each respondent. Marks were given for each question and it was consistent with the method used by Eriksen and Fallan (1996). Respondents with correct answers received a score of 3 (well informed), respondents with 'do not know' answer received a score of 2 (un-informed) and respondents with a wrong answer received a score of 1 (mis-informed)

RESULTS

The research model was tested using the SPSS for descriptive, correlation and reliability analysis. Then we proceeded to use AMOS version 20 to test the model using Structural Equation Modelling (SEM). In addition, multi-group analysis was conducted to test whether a moderating effect of tax knowledge exists. The sample was split into two groups, namely Data 1 and Data 2. Data 1 is renamed as low tax knowledge group and data 2 is renamed as high tax knowledge group. In order to determine whether the moderating variable affect the direction of attitude and intention to comply, this study used the criterion suggested by Hair et al. (2010). According to Hair et al. (2010), a moderating effect is present under two circumstances. In the first situation, beta for first group is significant while beta for second group is non-significant. In the second situation, beta for both group are significant but one is positive while the other is negative. The respondents' profile is presented in Table 1. There were a total of 225 respondents and the profile of respondents reasonably reflects the sample population of stall operators along the expressway.

The distribution of the 225 respondents shows that about 47.1 per cent of the respondents were males and 51.6 per cent were females. They are mainly in the 36 – 45 year old range (30.7 per cent) and only 4 per cent under the age 25 years. The majority of the respondents were Malays (86.2 per cent), and the remainders were Chinese (10.2 per cent) and Indian (1.3 per cent). About 23.6 per cent of the respondents have been in the business for less than 10 years, 44.9 per cent between 10 – 19 years and the remainder of 28.9 per cent have been in the business for more than 20 years. About 44.8 per cent of respondents engaged in food stalls and about 38.6 percent of respondents sell beverages. Meanwhile, about 9.4 percent of the respondents selling various kinds of local fruits and the rest of them that is 4.1 percent, selling handicrafts and other products. However, it was found that most respondents never filed their tax return (49.8 per cent) and 16.4 per cent of the respondents had filed their tax return for more 5 times. When asked whether the respondents have attending any seminars or courses organized by IRB, the majority of them (77.3 per cent) would response "no" even though the seminar was conducted without a charge.

TABLE 1: Demographic profile of respondents

Demographics	Frequency	Percentage
Gender		
Male	106	47.1
Female	116	51.6
Age		
Under 25	9	4.0
26 – 35	65	28.9
36 – 45	69	30.7
46 – 55	62	27.6
56 and above	18	8.0
Ethnicity		
Malay	194	86.2
Chinese	23	10.2
Indian	3	1.3
Business Duration		
Less than 10 years	53	23.6
10 – 19 years	101	44.9
More than 20 years	65	28.9
Types of Business		
Food	101	44.8
Beverages	87	38.6
Fruits	21	9.4
Others	9	4.1
Tax Filing Experience		
Never	112	49.8
Once	19	8.4
2 – 5 times	53	23.6
More than 5 times	37	16.4

Table 2 present the results of the moderating effect of tax knowledge on the relationship between attitude towards compliance and intention to comply with the tax laws. The results show a statistical significance on the moderating effect of tax knowledge under reporting compliance scenario. Hypothesis 1 is supported. However, no significant moderating effect of the tax

knowledge on attitude and intention under filing compliance scenario. Thus, hypothesis 2 was rejected.

TABLE 2: Results of Moderation Effect of Tax Knowledge on the Hypothesized Model

Constructs	Beta	<i>p</i>	CR	Result
Reporting Compliance				
Low Tax Knowledge	.335	.002	3.052	Supported
High Tax Knowledge	.213	.183	1.332	
Filing Compliance				
Low Tax Knowledge	.717	.000	5.548	Not Supported
High Tax Knowledge	.879	.000	9.415	

Tax knowledge was found to moderate the relationship between attitude and intention to comply under reporting compliance scenario. However, findings failed to support the moderating effect of tax knowledge on the relationship between attitude and intention to comply under filing compliance scenario. Both levels of tax knowledge produced insignificant path estimates.

DISCUSSION AND CONCLUSION

As for reporting compliance scenario, the findings suggest that having more tax knowledge did significantly improve their reporting compliance. Consistent with the previous arguments, individuals with higher levels of tax knowledge exhibit a more positive attitude towards tax and, in turn, increase tax compliance and reduced the propensity for tax evasion (Eriksen & Fallan, 1996; Palil, 2010). According to Palil & Mustapha (2011) the reason why an individual with higher tax knowledge are generally more tax compliant than those with a lower tax knowledge are that educated taxpayers may be more aware of their responsibility towards society and the benefits that the state provides. Apart from that, they were also aware of the tax reliefs available to them that can help reduce their tax burden. The tax knowledge that they acquired enable them to understand the chargeability of certain types of income as well as the deductibility of some expenses incurred. Therefore, taxpayers with high levels of tax knowledge will more cautious in handling their tax return to avoid being penalized for unintentional errors. Also, the more they learn about the tax system, the more they realize on the seriousness of tax evasion, and thus, indirectly increasing the

attitudes towards tax. In conclusion, the results of this study confirmed that taxpayers would improve their reporting compliance when they had better knowledge of the income tax law. Conversely, as stated by Loo, Mckerchar, & Hansford (2010) lack of tax knowledge did cause individual taxpayers to engage in numerous errors in tax returns, particularly those who prepared their own tax returns. This, in turn, would lead to unintentional non-compliance behaviour. However, they further added that, for some taxpayers who seem to have better knowledge on tax law might exercise better tax planning in terms of tax avoidance.

With regard to the impact of tax knowledge on filing compliance scenario, results provide no support for Hypotheses 2. Findings indicate that tax knowledge is not a moderator on the relationship between attitude and intention to comply. Thus, tax knowledge did not affect the strength and direction of the relation between these two variables. This does make sense because to file an income tax return, high level knowledge of tax laws are not necessary. It does not matter whether they have sufficient knowledge of tax laws, they would be able to file a tax return if they wanted to, even with minimum tax knowledge. As such, based on the case scenario presented to respondents, the tax knowledge may not be important in their decision to file or not to file a personal tax return.

The findings of this study could be used as a reference for any tax regime in order to improve the management of their tax system. It was found that taxpayers' compliance behaviour depends on their attitude towards the tax system. If taxpayers have favourable attitudes towards tax authorities, then this will lead to more compliance. In this study, the effects of guilt feelings and a strong sense of civic duty are the motivational forces leading to, or deterring, taxpayers engaging in noncompliant behaviour. Thus, tax authorities should be focusing on these emotional components if they wish to increase taxpayers' compliance. However, it is generally difficult to cultivate a more positive attitude towards voluntary compliance, particularly when they have unfavourable views of tax system. This is because an attitude is normally associated with someone's self perception where the tax authorities might have little or no control. As such, a relatively easier way to improve compliance is to focus on the issues of concern highlighted in this study particularly in the "reporting compliance scenario". Attitudes towards compliance could be improved by enhancing taxpayers' level of tax knowledge and emphasis on technical and computational aspects of filing returns. In other words, tax authorities may have to focus on the technical aspect of the tax knowledge and the content of the tax law in their efforts to improve taxpayers knowledge and reduce the complexity of the income tax systems.

Apart from that, the tax authority could play its role by disseminating all information regarding taxes collected and the details of how the tax revenue was spent. A lack of information can result in negative perceptions among taxpayers on the government spending of tax revenues even though the government might have spent the money wisely. Therefore, a long run campaigns through the public media and ongoing seminars for the taxpayers could be an effective way to communicate tax matters to general public. It is also recommended to introduce taxation as a compulsory subject at the secondary school level in order to educate the nations on the importance of tax in their life. In addition, tax courses also should be offered to other fields of study as currently tax courses are only offered for accounting students. By doing so, every person has sufficient tax knowledge to understand the tax laws and comply voluntarily.

To conclude, the information obtained from this study should assist policy-makers, particularly tax authorities, in reviewing and modifying current tax systems, where necessary, to improve voluntary tax compliance.

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