

IMPACT OF TAX FAIRNESS SYSTEM ON INDIVIDUAL COMPLIANCE BEHAVIORS IN PAKISTAN

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ABSTRACT

This research investigated the impact of tax fairness system on individual compliance behaviors in Pakistan. Objective of the study was to investigate the tax payers' attitude and compliance behavior. The study focused on the perception of individuals about the tax fairness system. Primary data was collected from individual tax payers through questionnaires. Results indicated that most of the individuals do not - pay their fair share of tax, consider tax payment their obligation and moral and social responsibility, and pay tax on its due time arising out of un-transparent tax system. Further the tax payers have strong reservations regarding tax system and think the current tax system is not transparent. The respondents are of the view that transparency and fairness in the system would directly add to the increase in tax revenue. The study is useful for tax authorities to know on the individual tax payers' perception about the tax system. The implication of the study has been discussed along with the limitations of the study and direction for future research.

Keywords: Tax payers, Compliance behaviors, FBR, Evasion.

INTRODUCTION

Tax compliance is the most discussed and burning issue in developing countries. The governments are in search to increase revenue sources so as to make efficient the tax collection system to properly finance their budgets (Maseko, 2014). In the developing countries taxes are important source of revenue to government (Tirra& Hudson, 2004). Revenue collecting authorities paid great attention to the behavior of tax payers and their perception about the fairness of tax system. Various researchers noted differences on the issues of tax collection between tax authorities and tax payers. In newspapers lot of tax evasion cases are being reported on daily basis. The tax evasion case greatly affects the government policy about revenue collection and greater attention has been given for the last few years. Most of research has been conducted on tax compliance behaviors in developed nations like USA, UK, France and Germany etc and little work has been done in the less developed world (Chuan& Lang, 2009; Torgler, 2003). Trivedi and Shehata (2005) argues that economic objectives e.g. profit maximization and detection of probability, business income tax payers perception in informal economy (Etchberr, 1992), underreporting (Erard& HO, 2002; Chabham, 2005) are among many important factors. The question is what has been done on the study of taxpayers behaviors towards the tax system of Pakistan based on their knowledge and information of the tax system. The Federal

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Bureau of Revenue of Pakistan has a complex tax return system that requires more good knowledge and information about the tax system that can reduce the complexity. Of Course, the tax system is not fully understood to most of the tax payers. Hence the purpose of this study is to find out the relation of tax fairness factors, tax knowledge and complexity on tax compliance behavior and will investigate the perception of tax payers about tax system of Pakistan. The study will help to highlight those factors of fairness which leads to high compliance level and will help the tax authorities in reduction of unfairness and non-compliance.

Relevant literature on the subject will be reviewed next followed by a presentation of the research design and methodology. The results of the study will be then reported and discussed, followed by a summary and conclusions. Suggestions for further research are presented in the final section. Data will be collected through questionnaire.

LITERATURE REVIEW

Tax compliance is the most discussed and burning issue in developing countries. The governments are in search to increase revenue sources so as to make efficient the tax collection system to properly finance their budgets (Maseko, 2014). Siahhan (2012) investigated a positive relationship between tax fairness factor and voluntary compliance behaviors. Tax knowledge and tax complexity are viewed as contributing factors towards non-compliance behavior among taxpayers (Saad, 2014). The behaviors of some tax payers may fall under the head of economic theories, while other may follow psychological theories (Trivedi & Shehta, 2005). A lot of work has been done to study the tax payers' attitude for tax fairness in countries such as Australia and USA. To study tax fairness in Asian context no research work has yet been conducted in spite of Gilligan & Richardson (2005), Richardson: 2006, Azmi & Perumal: 2008). An insignificant and negative moderating effect of risk on the mutual relationship of compliance behavior and perception of service quality of tax system has been studied (Alabeda, Affrin & Idris, 2001). Christense et al. (1994) highlighted these issues while defining fairness, its multidimensional nature, and to be separately define for individual and society, interventions with complexity and justification and cause of non-compliance. Christense et al. (1994) is in the view that it is difficult to define fairness. Tax fairness is not uni dimensional (Porcano, 1988; Richardson & Sawyer, 2001; Jackson & Milliron, 1986). Various dimensions of tax fairness have been identified by Garbing (1988) including general fairness, exchange fairness, attitudes towards tax, progressive and flat rate and self-interest.

In general behavioral research about compliance and particularly for tax compliance persists for improvement in voluntary tax compliance. Since the field is getting saturation day by day and grows rapidly, the best advantage can be taken by IRS by focusing on various aspects like money, time and personnel (Kornhauser, 2007). For measurement of reporting compliance, the impact of tax evasion on tax compliance should not be ignored; because of the important dimensions of voluntary compliance can directly affect tax calculation from gross income. So the impact of these factors could not be ignored. These factors include marginal tax rate, filing threshold, marital status and allowable child exemption (plumly, 2002). For identification and implementation the approaches to increase tax compliance and effective understanding of the drivers of taxpayers is needed. For enhancing

compliance behavior effective strategies should be adapted. For individuals, smaller groups and businesses the treatment and interference should fit to the situations accordingly (OCED, 2010). Brown and Mazur (2003) defines the tax compliance as multi-faceted that can be measured and should be defined theoretically by focusing on various types of compliance such as payment, filing and reporting compliance. While consideration on tax compliance, it can be divided into categories (Organization for Economic Cooperation, 2001). (Cummings *et al.* 2005) are of the view that by increasing pressure on individual tax payer directly leads to the increased compliance. They also argue that in tax compliance, evasion is the complex decision and could be affected by variety of factors. Increase in voluntary compliance should be the aim of tax authorities so as to reduce the tax gap (Silvani, 1992). As measured by GDP ratio tax compliance is a big problem in most of the countries throughout the world (Cobham, 2005).

This is too simple to measure the compliance behaviors but to find a scale which can exactly measure how voluntary compliance behaviors change in a tax related phenomenon e.g. rate is too much difficult task for the researcher (Barbutamisu & Palil, 2011) concluded that in determination of tax payer behaviors, offense and penalties on tax evasion and personal financial constraints are important considerations. Compliance behaviors vary from individual to individual depending on circumstances like source of income and also that the negative response to compliance is intentional or unintentional (Trivedi *et al.* 2005). One of the biggest issues in noncompliance literature that needs more attention of the researchers is that in spite of low level penalties and a minimum chance of auditing why people actually pay taxes (Feld & Frey 2005) found a positive relationship between compliance and tax evasion. (Bend *et al.* 2011) found no significant relationship between tax compliance behaviors and tax payer perception about the equity. To reduce the administrative cost to the minimum on compliance and increase the revenue, a well understanding of the individual motivation is needed, and also to direct the tax policies and strategies accordingly suggested by Azmi & Perumal, (2008). They are also in the view that the reactions of the tax payers towards the tax system are also important because the transparency of the system will increase the compliance among the tax payers.

RESEARCH METHODOLOGY

DATA COLLECTION

The data was collected through distribution of survey of questionnaire, the questionnaire were distributed among 60 Pakistani individual taxpayers out of which 50 questionnaire were received back. The sample has been taken from some of universities faculty Government Officials, Private sectors workers and some of the respondents were from banking sector. In questionnaire, 30 questions were asked from taxpayers. Out of these 30 items 14 were related to fairness factors and 7 to tax system knowledge, 03 each to intention, compliance complexity, and attitude factors. All of the respondents possessed, good knowledge and information about Federal Bureau of Revenue of Pakistan tax system.

Measurement Techniques

To measure the fairness factors, a questionnaire of 14 items including factors of general fairness horizontal fairness, vertical fairness personal fairness and administrative fairness were asked from respondents. General fairness concerned with the general evaluation of income tax system. Horizontal fairness addresses that equal tax treatment of the same income and economic situation and the vertical fairness is about the tax rate structure i.e. whether progressive rate or flat rate is better. Personal fairness directs personal judgment of tax payer. In light of income tax system, is favorable to him and administrative fairness covers the content of tax law which may be called as policy fairness and the process followed by the tax authority (procedural fairness). The questionnaire was adapted from the past research of (Azmi *et al.*, 2008). Little changes were made to questionnaire according to Pakistan tax system and tax environment. These items are scaled to reflect the fairness perception about the tax system. For the compliance behavior, 16 items were asked, which were taken on the basis of theory of planned behavior (Bend *et al.*, 2005) variables (intention to compliance). These statements are asked for the measurement of their comply behavior. The variables are scaled at Likert scale of 1-5. Data was incorporated in SPSS for further analysis. Correlation and mean & standard deviation techniques were used to examine the data.

The tax education, measured by 7 items as of previous literatures defines the tax education differently. The items are divided into two groups' legal knowledge and technical knowledge. Legal knowledge is the knowledge about the rule and regulations of tax system, responsibility of tax returns at time and penalties on the noncompliance, while technical knowledge is concerned with knowledge of filling tax return forms accurately for themselves. For the measurement of tax complexity, three questions were asked about compliance complexity. The complexity related to difficulty in understanding of tax manuals and material, and the complexity in compliance with their tax obligations. All items have weighted on 5 point likert scale, 1=strongly disagree, 2=disagree, 3=Neutral, 4=agree, 5=strongly agree.

DATA ANALYSIS

The attitude of tax payers are influenced by various factors which directly effect compliance behavior. Factors vary from country to country and from individual to individual. These factors include perception of the tax payers about tax authority (Ambrecht, 1998) understanding of tax system by the tax payers (Silvani, 1992; LeBaube, 1992) and cost of compliance (Slemrod *et al.*, 1992) etc.

The impact of tax fairness system is not well understood in Pakistan which may leads to various perspectives on the tax system fairness of the Federal Bureau of Revenue of Pakistan. Most of the respondents were in the view that the tax system in Pakistan is not fair. Moral and ethical concerns are more important for tax compliance. There is need to develop a sense of responsibility among the tax payers in Pakistan. The respondents were asked to fill a questionnaire and indicate their agreement or disagreement for some factors that influence individual perception about tax system in Pakistan. 5 points Likert scale was used, where 1=Strongly Disagree, 2= Disagree, 3= Neutral, 4=Agree, and 5= Strongly Agree.

Table No: 1 All Factors Effecting Tax Compliance and Non compliance

S. No	Factors	Mean	S. D
1	Fairness of Government in Collection of tax Revenue and its spending	3.2733	.68243
2	Administrative fairness by FBR and Omission of errors	3.0900	.98814
3	Individual attitude towards declaration of income	2.9000	.74154
4	Understanding of Tax laws and procedure	2.7333	.64594
5	Payment of tax with respect to earning ratio	2.4800	.89128
6	Understanding of Technicality of tax system For calculation of tax liability	2.4050	.59524
7	Personal feelings about individual share of tax	2.3867	.62582
8	Reporting of income earned from using skills	2.3800	.70954
9	Payment of tax at progressive rate	2.3133	.47814
10	Tax evasion is a guilty and criminal offense	2.2933	.42931

Source: Research Data

Results in table 1, indicate that most of the respondents are disagreed (Mean=2) that the tax revenue is fairly utilize by the government for overall development of the society and tax payments are according to the earning ratios or the tax rate is progressive. Most of the respondents do not fairly declare their income. The data indicate the lack of knowledge of individual's tax payers about tax returns procedures. Most of the respondents also differ (Mean=3 and SD is Insignificant) about administrative fairness of the Federal Bureau Revenue. This indicates that the image of tax authorities in the tax payers mind is also not good and they think that government spends much of the revenue on lavish things.

Table No: 2 Factors showing Individuals views about fairness of Tax system in Pakistan

S. No	Factors	Mean	S. D
1	Fair utilization of tax revenue by government	3.92	1.140
2	Every one is paying fair share of tax	3.80	1.212
3	Spending of tax revenue on unnecessary things by government	2.10	1.374
4	Individuals with similar income should pay similar tax	2.42	1.372
5	I will pay similar tax to other tax payers	2.32	1.096
6	Income before tax should equal income after tax	2.70	1.165
7	High income earners are subject to tax at progressive rate	1.76	.771
8	Middle income earners should be taxed at lower rate	1.76	.822
9	High income earners are paying high tax	3.42	1.071
10	I am paying my fair share of tax	1.86	.926
11	I am paying more than my fair share of tax	2.94	.935
12	Middle income earners are their fair share of tax	2.36	1.064
13	Correction of errors while calculating tax liability	2.92	1.243
14	FBR tax system is consistent	3.26	1.00

Source: Research Data

From table 2, we can conclude that most of the respondents disagreed with many Factors influencing the views about fairness of tax system (Mean=2 and SD is insignificant). The factors for fairness of the tax system i.e. spending of tax revenue by government for overall development of the society to achieve social goals, individuals with similar income should pay similar tax, income before and after

tax should be equal, high income should pay tax at progressive rate, correction of errors while calculating tax liability and the perception of individual regarding payment of fair share of tax.

Some of the respondents varied in the view (Mean=3 and SD is insignificant) with fair utilization of tax revenue by government and the perception that everyone in Pakistan pay fair share of tax, high income earners are paying more than low income groups and the perception that the tax system of FBR is consistent. This means that these factors depend on application procedure which may positively affect compliance.

Table No 3: Factors effecting individuals compliance behaviors

S. No	Factors	Mean	S. D
1	Tax payers can be imprisoned for non compliance	2.12	.627
2	Individuals should be prosecuted for non compliance	2.20	.833
3	Deadlines are only guidelines not a penalty	2.56	.929
4	All earners should be register with FBR	2.04	1.087
5	Don't need to pay tax on interest income	2.62	.901
6	Deduction of personal expenses while Calculating tax liability	2.88	1.172
7	Idea about claims for calculating tax liability	2.08	.853
8	Easy understanding of filing tax return	2.80	1.195
9	Difficulty of maintaining all records for tax purposes	2.30	.953
10	Easy understanding of CBR guide books	3.10	1.111
11	Reporting of income earned from all sources	2.24	1.041
12	An attempt to cheat for omitting Income earned by using skills 2.32	2.32	.978

13	Omission of income earned from trading with friends etc	2.58	1.162
14	Feeling upset for non declaration of full income	2.92	1.192
15	Feeling of guilty for non declaration of full income	2.36	1.102
16	Feeling of pleasure for non declaration of full income	3.42	1.126

Source: Research Data

Results in table 3, shows that strong relationship exists between attitudes factors and compliance behaviors factors in Pakistan. Most of the respondents disagree (Mean=2) that tax payers can be imprisoned for non compliance and one should be prosecuted for non payment of tax or for not meeting the deadlines. Most of the tax payers think that deadlines are only guidelines in tax filing procedure and not matching of guidelines is not a crime. Tax payers further think that it should not be necessary that all income earners should be registered with Federal Bureau of Revenue. The data indicates that the rules and procedure for tax filing are not easily understandable and they found it difficult to maintain all record for tax calculation.

Taxpayers think that this is not their duty to report full income to the authorities for calculating tax liability. This shows that income earned by using skills and interest earned should not be taxed, also the income earned from trading with friends, neighbors etc. is not tax deductible. Due to complexity of tax system and unawareness from tax procedures it is difficult for the individual tax payer to fully deduct their personal expenses and other claims from while calculating their tax liability. Respondents also disagreed for feeling guilty of noncompliance and for not declaring their full income for tax purpose. Some of the respondents differed (mean=3) for understanding guide books of FBR issued for tax payers.

CORRELATION

Pearson Correlation was performed in the table given below to mention the relationship between dependent and independent variables. As shown in the table Fairness factors (general fairness, Horizontal fairness, vertical fairness, personal fairness and administrative fairness) and Compliance factors (Legal Knowledge, technical knowledge, compliance complexity, intention and effective attitude) have significant strong positive relationship at ($r=.930, .947, .906, .870, .903, .903, .789, .908, .756$ and $.805$) level. This further depicts that there exists positive relationship between predictors and response variables following table shows correlation matrix. Provide standard formatting for correlation table.

	GF	HF	VF	PF	AF	LK	TK	CC	I	EA
1. General Fairness	-									
2. Horizontal Fairness	.930**									
3. Vertical Fairness	.947**	.973**								
4. Personal Fairness	.906**	.975**	.960**							
5. Administrative Fairness	.870**	.847**	.801**	.760**						
6. Legal Knowledge	.903**	.943**	.860**	.922**	.815**					
7. Technical Knowledge	.789**	.840**	.930**	.781**	.799**	.815**				
8. Compliance Complexity	.908**	.975**	.821**	.945**	.708**	.771**	.805**			
9. Intention	.756**	.978**	.688**	.851**	.741**	.645**	.759**	.865**		
10. Effective Attitude	.805**	.715**	.845**	.860**	.715**	.801**	.609**	.622**	.701**	

CONCLUSION, RECOMMENDATIONS AND SUGGESTIONS

From the data analysis this is concluded that most of the tax payers don't think that tax system in Pakistan is not fair and most of the tax revenue is spent on unnecessary projects/ things. It is difficult for individual tax payer to fully understand the tax system and procedure although some individuals are paying tax but they don't have the idea about tax system and their tax amount, they only know that their salary is tax deductible. Individual tax payers' perceptions indicate that most of the people don't pay their fair share of tax or high income earners are taxed at high rate. Tax payer donot think tax payment as their duty or moral obligation or to pay tax on due date. Individuals donot think that all sources of income should be taxable. The correlation results also show that the variables are strongly correlated to each other's. The study is in line with Sialvani (1992) who also found that voluntary increase in tax return should be the focus of tax authorities and Maseko (2014) that government authorities to take positive and strict steps for increase in tax returns.

Following are some recommendation to be made for improvement

Federal Bureau of Revenue should enhance their awareness campaign program regarding filling up of tax returns and some basic and related instructions, which will in turn increase the tax payers' ability to better understand tax laws and procedure. Tax authorities are required to take corrective steps for the fairness of tax return system. Only then, an improvement in tax return can be expected. Moreover the authorities are further required to start so that, taxpayers may realize the tax payment as their moral and social responsibility. For tax compliance moral and ethical concerns are more important and there is a need to develop a sense among tax payers that tax payment is not a liability only but also their moral and social duty to pay tax on due time and meet the requirements for tax filing. The government needs to implement strict regulations for check and balance on tax revenue. The revenue authority should ask for feedback and suggestion for improvement of tax filing procedure from tax payers from time to time and take steps for corrective measure, so as, to make the tax filing and collection process easy for the peers and strengthen the economy.

LIMITATIONS

The study was conducted by having focus on salaried individuals and on very limited numbers of respondents. As tax withholding agents deduct taxes directly from their salary bills, most of them are unaware of their total tax share in fiscal year and also their majority was reluctant to disclose their income.

SUGGESTIONS FOR FUTURE RESEARCH

Further research in the area should focus on investigating the relationship of tax fairness system and the direct proportion of citizens. Similar study should also be carried out for studying the for SME's owner and business community.

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