Australian Journal of Basic and Applied Sciences, 5(11): 557-563, 2011
ISSN 1991-8178

The Evolution and Concept of Tax Compliance in Asia and Europe

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Abstract: This paper discusses the concept of tax compliance from various perspectives. The objective of this paper is to provide further understanding in tax compliance discipline by reviewing previous international literature. The paper begins with the concepts and the definitions of tax compliance and tax non-compliance followed by measure of national tax compliance in various countries such as India and Austria. This paper also discusses the various definitions of tax compliance provided by previous authors from various backgrounds and countries from 1960s. The measures that need to be taken by tax authorities and government to increase compliance also discussed in later part of this paper. although various studies have been undertaken to determine as accurately as possible the factors that impact upon tax compliance behaviour, undoubtedly, the government should consider seriously the characteristics of non compliant taxpayers, review current regulations and possibly as a result, increase audit rates and penalty rates (enforcement) as well as attempting to build good relationships with taxpayers in seeking to improve general tax compliance levels.

Key words: Tax compliance, definition and concept, Asia, Europe.

The Concept and Definition of Tax Compliance:

Tax compliance is a major problem for many tax authorities and it is not an easy task to persuade taxpayers to comply with tax requirements even though ‘tax laws are not always precise’ (James and Alley 2004: 29). The exact meaning of tax compliance has been defined in various ways. For example, Andreoni, Erard, and Feinstein (1998) claimed that tax compliance should be defined as taxpayers’ willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers’ willingness to pay their taxes. A wider definition of tax compliance, defined in 1978 by Song and Yarbrough suggested that due to the remarkable aspect of the operation of the tax system in the United States and that it is largely based on self assessment and voluntary compliance, tax compliance should be defined as taxpayers’ ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pays the right amount of taxes on time (Internal Revenue Service (IRS), 2009; Australia Tax Office (ATO), 2009; Inland Revenue Board of Malaysia (IRB), 2009).

Alm (1991) and Jackson and Milliron (1986) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Another definition of tax compliance is a person’s act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority (Singh, 2003). Furthermore, tax compliance has also been segregated into two perspectives, namely compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns (Chow, 2004; Harris, 1989). Compliance in pure administrational terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames (Ming Ling, Normala and Meera, 2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Singh and Bhupalan, 2001). In line with Singh and Bhupalan, Somasundram (2003, 2005a and 2005b) claimed that the wider perspective of compliance becomes a major issue in a self assessment system since the total amount tax payable is highly dependent on the levels of tax compliance this perspective reveals, although it is inevitable that tax authorities will seek to ‘influence’ the areas taxpayers have influence over determining to reduce the risks of non-compliant behaviour they face otherwise e.g through continuously conducting tax audits of different sorts and other means such as various compliance influencing activities including tax education.

Some authors have viewed tax compliance from a different perspective. For example, Allingham and Sandmo (1972) described tax compliance as an issue of ‘reporting an actual income’ and also claimed that tax compliance behaviour was influenced by a situation whereby taxpayers have to make a decision under

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uncertainty (see also Clotfelter, 1983) i.e either taxpayers would enjoy tax savings due to under-reporting income or have to pay tax on the undeclared amount at a penalty rate which is higher than they would have paid had the income been fully declared at the correct time.

In 2001, McBarnet suggested tax compliance should be perceived in three ways, namely; a) committed compliance - taxpayers' willingness to pay taxes without complaint; b) capitulative compliance - reluctantly giving in and paying taxes and c) creative compliance – engagement to reduce taxes by taking advantage of possibilities to redefine income and deduct expenditures within the bracket of tax laws. Spicer and Lundstedt (1976) perceived degrees of tax compliance as 'a special form of gambling' (which, may involve likelihood of detection and penalties) (p. 295) which requires the tax authority to understand the factors underlying taxpayers' decision to comply with tax laws (p. 295).

Some literature like Allingham and Sandmo (1972), Spicer and Lundstedt (1976), Lewis (1982) and Andreoni, Erard, and Feinstein (1998) therefore characterise and explain tax compliance as the output of interrelation among variables including perception of equity, efficiency and incidence (public finance views). Tax enforcement aspects like penalties and the probability of detection also relate to tax compliance while other labour market behaviour factors including an individual's wages and tax bracket also contribute to tax compliance (Kirchler, 2007).

Based on previous authors' definitions, there are some keywords which were widely and interchangeably used to define tax compliance. For example, the words 'obey', 'ability' and 'willingness' (McBarnet, (2001); Andreoni *et al.* (1998); Kirchler (2007); Song and Yarbrough (1978); IRS (2009); ATO (2009) and IRB (2009)). Other keywords were also relevant in defining tax compliance i.e 'reporting all income' (Alm, 1991; Jackson and Milliron,1986), 'act of filing tax returns' (Singh, 2003), 'declare the correct income' (IRS, (2009); ATO, (2009) and IRB (2009)). In addition, some authors also included 'timeliness', 'right amount of tax' (Song and Yarbrough (1978); IRS, (2009); ATO, (2009) and IRB (2009); Ming Ling, Normala and Meera 2005) as part of their definitions.

The wider perspective of tax compliance was also illustrated in the definition provided by Andreoni *et. al.* (1998) in which they included the desired outcome as a result of obedience to tax laws – 'to obtain an economic equilibrium'; Allingham and Sandmo (1972) and Spicer and Lundstedt (1976) – 'enjoy tax saving' or 'penalty'. Singh (2003) described tax compliance as voluntary action – 'without having to wait for follow up actions from tax authority'. Apart from these, Song and Yarbrough (1978) included some factors of compliance in their definition i.e. 'determined by ethics, legal environment and other situational factors'.

Since there have been many empirical studies attempts have been made to define tax compliance, it can be concluded that, (based on IRS, (2009); ATO, (2009) and IRB (2009); Alm (1991); Jackson and Milliron (1986) and Kirchler (2007)), tax compliance is defined as *taxpayers' willingness to comply with tax laws, declare the correct income, claim the correct deductions, relief and rebates and pay all taxes on time.*

Tax Non-Compliance:

In contrast with tax compliance, tax non-compliance is defined as taxpayer's failure to remit a proper amount of tax, perhaps on account of the complexity or even contradictions in the tax legislation or tax administration procedure (Jackson and Milliron, 1986: Kesselman, 1994: Kasipillai and Jabbar, 2003). Non-compliance is also perceived as the failure of a taxpayer to report (correctly) the actual income, claim deductions and rebates and remit the actual amount of tax payable to the tax authority on time (Kirchler, 2007). Some studies also segmented income tax non-compliance into unintentional and intentional behaviour (e.g Loo 2006; Mohani, 2001; Kesselman, 1994 and Allingham and Sandmo, 1972). Thus, in conclusion, based on Jackson and Milliron (1986): Kesselman (1994): Kasipillai and Jabbar (2003) non-compliance is defined for the purpose of this study as *failure to comply with tax laws and/or report incorrect income, the act of claiming incorrect deductions, relief and rebates and/or paying the incorrect amount of tax beyond the stipulated time frame.*

As the literature cited has therefore shown, tax compliance is a wide concept and can be viewed from many perspectives, including public finance, economic, legal and also psychological. James and Alley (2004) suggested two contrasting approaches pertaining to tax compliance as a summary of the extremes of ways of defining this topic (as illustrated in Table 1).

Measures of National Tax Compliance:

This section discusses various proposed measures of tax compliance in individual country studies e.g India as well as tax compliance indexes of various countries. The indexes as suggested by some authors i.e Riahi-Belkaoui (2004), Torgler and Schneider (2005) and Torgler (2007) are useful in order to evaluate the degree of tax compliance problems throughout the world and provide a comparative measure of tax compliance behaviours.

A study by Das Gupta, Lahiri and Mookherjee (1995) attempted to provide a tax compliance index in India from 1965 to 1993. They constructed an aggregate index in which tax compliance was defined to be the ratio of actual income tax revenue receipts (ITR) to the amount of taxes that were actually due to the government. According to Figure 1, the results indicate that the compliance index in India was declining from 1965 to 1974. The index slightly increased in 1975 until 1977 before sharply decreasing until 1984. The index then increased in 1985 before constantly decreasing until 1993.

Table 1: Approach to tax compliance.

Tax Compliance	First Approach	Second approach
Concept of:	Tax gap 100% compliance less actual revenue	Voluntary Willingness to act in accordance with the spirit as well as the letter of tax law.
Definition	Narrower	Wider
Tax compliance	Economic rationality	Behavioural co-operation
Exemplified by:	Trade off: 1. Expected benefit of evading. 2. Risk of detection and application of penalties. 3. Maximise personal income and wealth	Individuals are not simply independent, selfish utility maximisers. They interact according to differing attitudes, beliefs, norms and roles. Success depend on co-operation
Issues of:	Efficiency in resource allocation	Equity, fairness and incidence.
Taxpayer seen as	Selfish calculator of pecuniary gains and losses	"good citizen"
Can be termed the:	Economic approach	Behavioural approach

Source: James and Alley (2004), p. 33.

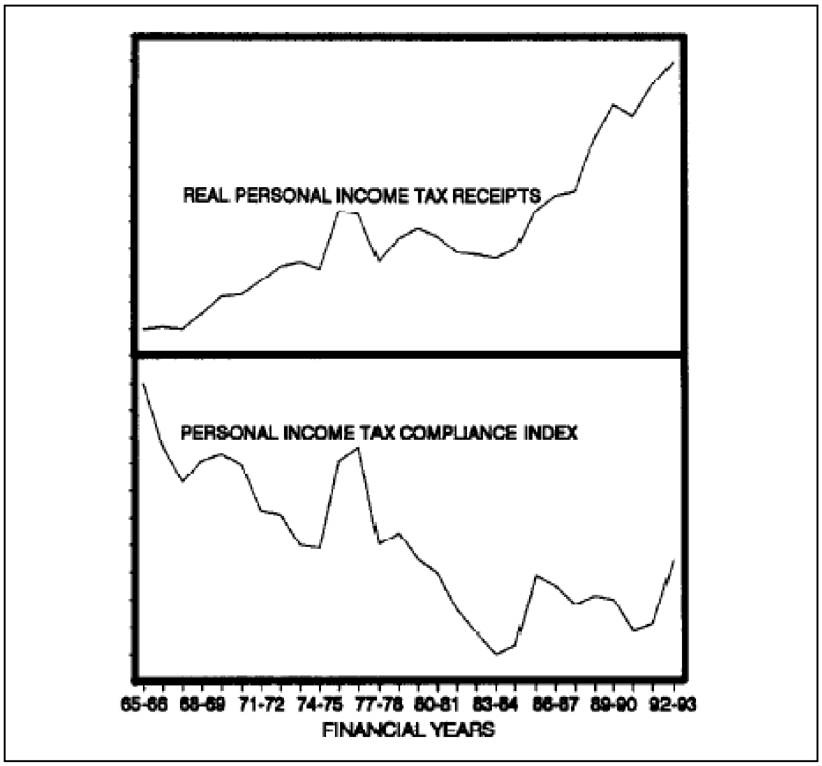

Fig. 1: Compliance Index in India 1965 -1993.
Source: Das Gupta, Lahiri and Mookherjee (1995) p. 2,056.

This study has a number of limitations. The proxy used for scrutiny assessment activity may be unsatisfactory and the compliance measure is biased, perhaps seriously, due to problems with the measurement of the average effective tax rate and non agriculture gross domestic product (NAGDP). Others therefore have developed alternative measures of compliance using better estimates of income distribution.

Riahi-Belkaoui (2004) attempted to compare the level of compliance in thirty countries worldwide. In this study, tax compliance in each country is measured based on four variables, namely situation of high economic freedom, importance of equity markets (the degree that each country depends on equity financing), effective competition laws (measured by the answer to survey questions) and high moral norms (violent crime rates is used as proxy), Economic freedom is measured by the 1999 summary economic freedom index from Gwartney, Lawson and Samida (2000). Economic freedom is viewed from seven areas including size of government;

economic structure and use or markets; monetary policy and price stability; freedom to use alternative currencies and legal structure and security of private ownership. Riahi-Belkaoui used a regression equation to examine these tax compliance determinants.

Table 2 demonstrates the results conducted by Riahi-Belkaoui. According to the table, it seems that the highest compliance rate is from developed countries like Singapore, New Zealand, Australia, the UK and Hong Kong. Surprisingly, among the lowest compliance indexes are from European countries like Italy, Sweden, Turkey, Portugal and Poland. Although the results of Riahi-Belkaoui's study are important, impressive and interesting the reliability is questionable because he was using subjective measurements and indicators which have different impacts on each country. However, it is has become a benchmark and key indicator tool in the tax compliance discipline.

Table 2: Tax compliance index internationally.

Name of country	Tax compliance
Singapore	5.05
New Zealand	5.00
Australia	4.58
UK	4.67
Hong Kong	4.56
Switzerland	4.49
USA	4.47
Malaysia	4.34
Chile	4.20
Japan	4.41
Norway	3.96
France	3.86
Canada	3,77
Denmark	3.70
Austria	3.60
Finland	3.53
Germany	3.41
Thailand	3.41
Philippines	3.83
Netherlands	3.40
Spain	3.29
Taiwan	3.25
Cambodia	3.12
Indonesia	2.53
Mexico	2.46
Argentina	2.41
Poland	2.19
Portugal	2.18
Turkey	2.07
Sweden	1.91
Italy	1.77

Source: Riahi-Belkaoui (2004) p. 138.

Torgler and Schneider (2005) attempted to improve on the Riahi-Belkaoui study's contributions to this field of knowledge, although limited their work to a single country analysis (Austrian) taxpayers' attitudes toward paying taxes or 'tax morale'. The authors suggest that Austria is an interesting country to investigate as there is a high degree of tax morale over time (p. 232). Their study was based on the World Values Survey (WVS) and the European Values Survey (EVS) data of 1990 and 1999. WVS (and EVS) is a worldwide investigation of socio-cultural and political change based on representative national samples. Tax morale was measured by the following question (p. 233): *"please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between: …Cheating on tax if you have the chance"*, followed by a 10-scale index with two extreme points 'never justified' and 'always justified' (p. 233). Of 1,447 WVS and 1,497 EVS observations, the study suggested that Austrian taxpayers' tax morale decreased between 1990 and 1999 although they note that tax morale in Austria was still high compared to in other European countries. Torgler and Schneider (2005) found that tax morale in Austria was influenced by societal variables such as trust, national pride and religiosity. They also found that if taxpayers perceive that tax non-compliance is a common phenomenon, their intrinsic motivation to contribute to the society decreases.

In 2007, using the same method as Torgler and Schneider (2005), Torgler analysed the level of tax morale in transition countries and found that tax morale in East Germany was quite high, exceeding the tax morale in the Former Soviet Union (FSU) and Central and Eastern Europe (CEE) in both years. The details of the results are exhibited in Table 3.

Table 3: Tax compliance in transition countries.

Countries	Mean
	1995-97
East Germany	1.919
Former Soviet Union	
Armenia	1.508
Azerbaijan	1.634
Belarus	1.518
Estonia	1.560
Georgia	1.760
Latvia	1.379
Lithuania	1.687
Moldova	1.426
Russia	1.663
Ukraine	1.558
Average	1.576
Central and Eastern Europe	
Bulgaria	2.240
Bosnia	2.172
Croatia	1.309
Hungary	
Macedonia	2.109
Montenegro	1.749
Poland	2.001
Romania	
Slovenia	1.913
Serbia	1.969
Average	1.718

Source: Based on Torgler (2007) p. 220.

Previous studies (i.e. Das Gupta *et. al.*, 1995; Riahi-Belkaoui, 2004; Torgler, 2007) have shown that tax compliance indexes vary among countries. Although these studies have different approaches, variables, different tax laws and measurements, the coefficient provided by those studies is relatively important for future research and benchmarks.

Conclusions:

Tax compliance has been an important subject of research in a large number of developed and a number of developing countries. Since each country has its own approach to managing tax compliance levels and each has different tax laws and regulations, the factors impacting tax compliance behaviour appear to vary among countries. Factors affecting tax compliance can be viewed from various continuums; for example, economists and policy analysts have given increasing attention to tax compliance theoretically and empirically (Clotfelter, 1983).

Cultural difference was a factor that impacted tax compliance in the US and Hong Kong (see Chan *et. al.,* 2000; Richardson, 2008). Tax knowledge appears to be an important element in tax compliance but the degree of required level of knowledge varies among countries (see Lewis, 1982; Eriksen and Fallan, 1996; Loo, 2006; Kim, 2008). Economic factors such as tax rates, tax audits and perceptions of government spending as well as institutional factors (the role of the tax authority, simplicity of the tax return and administration, and probability of detection) have both positive and negative associations with tax compliance. Generally, policy makers are interested in tax compliance for two main reasons: its revenue implications and equity concerns. With tax rates fixed, tax non-complaince decreases the government's revenue. Reduction in tax revenue attracts policy makers' attention and makes them take steps to alleviate the problem. This is particularly noticeable when the government faces poor fiscal conditions such as serious fiscal deficits and global economy recessions. A further reason that policy makers worry about tax non-compliance is on equity grounds. Previous research suggests that tax non-compliance levels vary across age, gender, income and education etc. These variations inevitably result in an equity problem among various groups of citizens: citizens who cannot or do not evade taxes raise an equity issue against those evading them.

In conclusion, although various studies have been undertaken to determine as accurately as possible the factors that impact upon tax compliance behaviour, undoubtedly, the government should consider seriously the characteristics of non compliant taxpayers, review current regulations and possibly as a result, increase audit rates and penalty rates (enforcement) as well as attempting to build good relationships with taxpayers in seeking to improve general tax compliance levels.

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