



International Conference on Accounting Studies 2014, ICAS 2014, 18-19 August 2014, Kuala Lumpur, Malaysia

## The impact of threat of punishment on tax compliance and non-compliance attitudes in Malaysia

Raihana Mohdali<sup>a\*</sup>, Khadijah Isa<sup>b</sup>, Salwa Hana Yusoff<sup>b</sup>

<sup>a</sup>UTM Razak School, Universiti Teknologi Malaysia, Jalan Semarak, 54100 Kuala Lumpur, Malaysia

<sup>b</sup>International Islamic University Malaysia, Jalan Gombak, 53100 Kuala Lumpur, Malaysia

---

### Abstract

Threat of punishment has been emphasized as one of the effective tools to deter taxpayers' non-compliance attitudes. Thus this study aims to explore the impact of threat of punishment on both individual taxpayers' attitudes, compliance and non-compliance. The findings from a mixed-modes survey indicate that threat of punishment is insignificant on taxpayers who are willing to comply with tax laws. They tend to avoid taxes when they are threatened with tax audits and penalties. Overall, threat of punishment appears to have not only an insignificant impact on compliant taxpayers but also trigger their intentions to be less compliant.

© 2014 Published by Elsevier Ltd. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/3.0/>).

Peer-review under responsibility of the School of Accountancy, College of Business, Universiti Utara Malaysia.

*Keywords:* Voluntary tax compliance; tax avoidance attitude; threat of punishment

---

### 1. Introduction

Taxpayers are expected to be deterred by threat of punishment from the tax structure, namely through tax audits, penalties and tax rates. Prior research mainly focuses on the impact of threat of punishment on tax evasion because the changes in the tax structure are anticipated to change the way people behave in fulfilling their tax obligations. However, the direction of tax research has shifted since 1990s in order to try to understand the positive

---

\* Corresponding author. Tel.: +6-03-2615-4584.

E-mail address: [raihana@ic.utm.my](mailto:raihana@ic.utm.my)

attitudes of taxpayers rather than the negative attitudes of taxpayers. This is because despite the slim chances of being audited or reasonable penalties being imposed on tax evasion, most people are willingly abide by tax laws. In general, there is a large body of theoretical and empirical evidence to support the view that threat of punishment such as higher audit probabilities and penalties encouraged compliance and higher tax rates discouraged compliance. However, there are other studies that pointed to different direction.

Therefore, the aim of this study is to determine the impact of threat of punishment on both compliance attitudes of individual taxpayers namely voluntary tax compliance and tax avoidance attitude in a study. However, the only tax structure element employed in the present study was the tax audit and penalty to measure the threat of punishment variable. The tax rate element was excluded because the Malaysian residents follow a progressive tax rate schedule and tax audit and penalty elements appear to be more influential in compelling taxpayers to make positive compliance decisions. The remainder of the paper is organized as follows. The next section briefly reviews the literature regarding the influence of threat of punishment in tax compliance studies. This discussion is then followed by the presentation of the methods used in this study. Next, the findings of the study are presented. The subsequent section provides a discussion of the overall findings together with the theoretical and policy implications. Several limitations of the current study are acknowledged and the final section concludes the paper.

## **2. Threat of punishment and tax compliance**

Fear has been used by tax authorities as a means to force taxpayers to conform to tax laws given that a taxpayer is viewed as a “perfectly amoral, risk-neutral or risk-averse, utility maximizing individual who chooses to evade tax whenever the expected gain exceeded the cost” (Milliron & Toy, 1988, p. 85). The economic deterrence approach was developed based on the economics-of-crime model, introduced by Becker (1968) to optimize the public and private policies in fighting illegal behavior since threats of punishment are expected to encourage lawful behavior. Basically, it is assumed that the tax compliance decision is made by a taxpayer under uncertain circumstances, strictly due to the fear of the possibility of being caught and penalized (Alm & McKee, 1998).

The threat of punishment, consisting of tax audits, tax penalties and tax rates, is used in most countries to deter taxpayers’ non-compliance behavior. In general, most of prior studies showed a positive correlation between audit probability and compliance (Fischer, Wartick, & Mark, 1992). However, the impacts of audit probabilities on tax compliance are varied depending on the group of taxpayers. For example, audit probabilities were found to have strong influences on tax compliance for sole proprietors but only little effect on salaried taxpayers (Witte & Woodbury, 1985). Hence, tax audits that specifically target a certain group of taxpayers seem to be more effective in increasing tax compliance rather than random audits (Hasseldine, 1993). Further, audit probabilities may only affect taxpayers who have the intention to evade (Hanno & Violette, 1996; Trivedi, Shehata, & Lynn, 2003). Spicer and Thomas (1982) suggested that taxpayers may only abide by tax laws when they have definite information about the possibilities of being audited.

There are mixed findings on the influence of penalties. A number of studies (for example: Beck, Jon, & Jung, 1991; Park & Hyun, 2003) indicated a positive influence of higher penalty on tax compliance but other studies (for example: Alm, Bahl, & Murray, 1990; Alm, Jackson, & McKee, 1992) lead to the opposite findings. The severity of the penalty may only discourage taxpayers from reporting their true incomes because the possibility of gaining is greater than the possibility of losing (Slemrod, 2004). In addition, the impact of penalty also varies according to group of taxpayers. For example, the severity of criminal fraud penalties was found to be positively related to the behavior of high income self-employed individuals (Alm, Bahl, & Murray, 1990). On the other hand, civil penalties appeared to have negative relationships with the behaviors of small proprietors and middle income individuals (Witte & Woodbury, 1985).

Studies that examined tax rates as a compliance variable have produced mixed results. For instance, it is apparent that taxpayers are prone to understate their incomes when the marginal tax rate is increased (Clotfelter, 1983; Skinner & Slemrod, 1985). In other words, higher tax rates will pressure taxpayers to be less compliant. Feinstein (1991), however, discovered conflicting findings which were in line with the findings by Etzioni (1986), that is, despite the fact that the tax rate was stable, the tax compliance rate was still low. Sandmo (2005) in his

review of the theory of tax evasion believed that the tax rate was not among the main factors that influenced taxpayers' decision-making as compared to the penalty and audit rate.

In Malaysia, the tax structure, consisting of tax rate, audit rate and penalty rate, is apparently influential on taxpayers' compliance behaviors as evident in an experimental study involving two groups of undergraduate students (Loo, 2006b). A mixed-methods study (a survey and an experiment) also demonstrated the same findings except for tax audit which was found to be less effective for salaried taxpayers (Loo, McKerchar, & Hansford, 2009). This may be because the scheduler tax deduction is imposed on the majority of salaried taxpayers in Malaysia. However, the penalty rate appeared to be the most influential tax compliance determinant of tax compliance attitudes in a comparison study of taxpayers' compliance attitudes before and after the implementation of the SAS (Loo, 2006a). Despite the tax structure being evident to deter the non-compliance behavior of taxpayers, the enforcement of the rules was viewed to be rather loose which may reduce the integrity of the IRBM in the eyes of taxpayers. Overall, the threat of punishment remains significant in deterring the negative intentions or attitudes of taxpayers.

### 3. Research method

The main principle of a survey is to gather original data directly from a population through a survey of a fraction of the population to reflect the larger population (Salant & Dillman, 1994). It is regarded as an excellent method in rationalizing an individual's attitude towards certain issues (Babbie, 2008), hence a self-administered survey was utilized in this study for that purpose. One of the most successful techniques to avoid low response rates in a survey is to employ a drop-off method (Dillman, 2007). However, a drop-off survey is also considered to be costly since it requires travelling from one location to another for hand deliveries and retrievals of questionnaires (Zikmund, 2003). Thus an online survey was then selected as a second method since it is known for its economic advantage as an inexpensive method (Van Selm & Jankowski, 2006). There is a possibility of responses received from one mode may differ from responses received in the other mode but only little impact is expected (de Leeuw, 2008). Thus both a drop-off and online survey were used in this study.

The current study only involved individual taxpayers in Malaysia comprising salaried and self-employed taxpayers. The potential respondents for drop-off survey were selected based on proportionate stratified sampling according to the proportion of ethnic groups in Malaysia namely Malays and other indigenous groups (66 percent), Chinese (25 percent) and Indians (8 percent) (Department of Statistics Malaysia, 2001). A total of 450 questionnaires were sent to seven companies and distributed by the intermediaries to salaried taxpayers and the balance, 50 questionnaires were sent personally to self-employed taxpayers. A survey link was also forwarded to both salaried and self-employed taxpayers.

Three constructs were developed to measure individuals' attitudes towards tax compliance and their perceptions towards threat of punishment. The items for these constructs were adapted from the literature review and self-developed. Tax compliance attitudes were represented by two dependent variables namely voluntary tax compliance (VTC) adapted from Kirchler and Wahl (2010) and Braithwaite, Murphy, and Reinhart (2007); and tax avoidance attitude (TAA) adapted from Gilligan and Richardson (2005) and Niemiowski and Wearing (2006). The independent variable namely threat of punishment (ToP) was adapted from Verboon and van Dijke (2007) and one item was self-developed. All three constructs were measured on a 5-point Likert scale (1 = strongly disagree, 5 = strongly agree).

### 4. Findings

The total usable responses from both methods was 302 with 197 responses were received from the drop-off survey and 105 responses from the online survey. The responses from these two methods were combined because the same questionnaire was used in both methods and the t-test results show there were no significant differences between data from both methods such as ( $t(300)_{VTC} = 0.91, p = n.s.$ ). The percentage of Malay (78 percent)

involved in this study appeared to be over representative compared to Chinese (17 percent) and Indians (5 percent), but the overall sample was considered acceptable because it reflected the actual ranking of Malaysian proportion in the population. Almost 90 percent of the respondents were salaried taxpayers and 10 percent were self-employed taxpayers. The overall mean score for voluntary tax compliance and tax avoidance attitude is 3.67 and 2.53, respectively. This result demonstrates high voluntary tax compliance among the respondents and negative inclination towards the component of tax avoidance attitude.

There were mixed attitudes that shaped the respondents' compliance attitudes in terms of the impact of the threat of punishment as shown in Table 1. A large number of respondents appeared to disagree with the third (ToP3) and second (ToP2) items with a percentage of 62 and 40, respectively. They believed in a high possibility of being audited and a high chance of being discovered and punished by the IRBM. On the contrary, more than 45 percent of the respondents appeared to agree that the potential of being tracked by the IRBM was unlikely if it involved the understatement of income or overstatement of expenses (ToP4). The respondents' awareness of the type and extent of penalties and risks indicated similar percentages, around 30 to 35 percent in all three categories of attitudes for the first item (ToP1). The overall mean score of 2.85 illustrated the respondents' disagreement but the inclination was towards a neutral attitude.

Table 1. Attitudes towards the threat of punishment

Item	Statement	Mean	Med.	SD	Strongly Disagree/ Disagree	Neutral	Strongly Agree/ Agree
ToP1	I am NOT aware of the type and extent of penalties and risks that exist for income tax evasion in Malaysia.	2.98	3.00	1.00	108 (35.7)	95 (31.5)	99 (32.8)
ToP2	It is unlikely for taxpayers to be discovered and punished by the IRBM if they were to evade income taxes.	2.83	3.00	0.99	122 (40.4)	99 (32.8)	81 (26.8)
ToP3	I do NOT pay taxes as required by the regulations because I know the probability of being audited is very slim.	2.44	2.00	1.01	188 (62.3)	63 (20.9)	51 (16.8)
ToP4	The IRBM rarely finds out if someone has overly understated their income or overstated their deductions.	3.13	3.00	1.01	104 (34.4)	62 (20.5)	136 (45.1)
ToP	-	2.85	2.75	0.70	-	-	-

\* The percentage of responses is given in parentheses and some of them do not total up to one hundred percent due to rounding.

\*\* n = 302.

The threat of punishment was found to have a negative relationship with voluntary tax compliance and not statistically significant ( $r = -0.003$ ). In contrast, it was found to have positive significant correlation with tax avoidance attitude ( $r = +0.38$ ). A simple regression analysis indicated that threat of punishment was insignificant ( $\beta = 0.08$ ,  $p = n.s.$ ) in explaining voluntary tax compliance but a significant ( $\beta = 0.06$ ,  $p = 0.00$ ) predictor of tax avoidance attitude.

## 5. Discussion of findings

The highest mean score perceived by individual taxpayers in Malaysia between two tax compliance components was voluntary tax compliance. This may indicate a high tendency of individual taxpayers in Malaysia to comply voluntarily with tax laws which lends support to the prior research (Loo, McKerchar, & Hansford, 2010). One of the potential explanations for this strong positive attitude may be because the majority of the respondents were salaried taxpayers. Being salaried taxpayers, a portion of taxpayers' salaries was deducted automatically by their employers for payment of income taxes based on the scheduler tax deduction set up by the IRBM. Further, the employment of the e-filing system in Malaysia probably offers an easy and economical transaction for taxpayers who have straight-forward tax affairs such as salaried taxpayers who were the majority of the respondents in this study. The provision of convenient and inexpensive ways to deal with the tax authority is stressed by McKerchar

and Evans (2009) as an important strategy in fostering voluntary tax compliance. Thus high levels of voluntary tax compliance were evident among the individuals in this study.

The influence of threat of punishment on tax compliance components in this study was found to be positively statistically significant only on tax avoidance attitude. The threat of punishment has encouraged taxpayers to be more inclined towards the tax avoidance attitude. Since they were already willing to comply, the use of threat of punishment may only encourage them to be less compliant which might indicate their rebellious attitude against the government. This is probably because compliers are less likely to be affected by the threat of punishment as compared to non-compliers (Hanno & Violette, 1996) but the threat of punishment might trigger rather than discourage negative intentions or attitudes. This lends strong support to prior Malaysian studies, even though the term used is different (Loo, 2006a; Loo et. al., 2009). Tax structure (tax audits and penalties) appeared to have an indirect influence on tax compliance which led some taxpayers to over-comply. However, their main reason for complying was to get a tax refund.

The insignificant impact of the threat of punishment on taxpayers' positive attitudes probably reflects the salaried taxpayers being the majority in the current study. This was probably because they had less opportunity to avoid or even to evade paying taxes because their tax affairs were direct and simple. Self-employed taxpayers were considered to have more complicated tax affairs that enable them to make use of the various loopholes in the income tax rules. This strongly supports the prior international (Witte & Woodbury, 1985) and Malaysian (Loo et. al., 2009) studies that showed the prospect of a tax audit was ineffective for salaried taxpayers. However, the threat of punishment still appeared to be effective if they had the intention to avoid taxes, regardless of their employment status.

One important policy implication for the IRBM from this study is probably to communicate the positive and negative information to taxpayers as practiced by the Australian Tax Office (2012). For example, the Australian Tax Office plan for compliance activities for 2012 to 2013 were released to the public in July 2012 as a means of communicating relevant information to taxpayers and the compliance information is also conveyed through the media and tax practitioner community. It is probable that such a targeted policy could be practiced in Malaysia. For example, positive information is probably effective for salaried taxpayers in Malaysia because they have strong intentions to voluntarily comply so that they can easily respond to positive appeals from the tax authority and negative information most probably is more appropriate to threaten taxpayers who have the intention to evade taxes. Interestingly, both types of information are found to be effective on "high opportunity" taxpayers such as the self-employed (Hasseldine, Hite, & Toumi, 2007, p. 189).

The most apparent limitation of this research is that it relied on a self-reported method to collect data and that may have led to inaccuracies in the data. This is because respondents may interpret the questions differently according to their understanding and may misunderstand the questions because of certain terminologies even though reasonable efforts were made to ensure the wording was simple and precise. The second obvious limitation was the selection of taxpayers involved in this study. Even though several attempts were made to include more self-employed taxpayers in the surveys, the salaried taxpayers remain as the majority of the total respondents. Furthermore, the opportunities to avoid or evade paying taxes between these two types of taxpayers are different because salaried taxpayers have fewer opportunities to evade compared to self-employed taxpayers (Braithwaite, 2003). Thus they might have different perspectives and attitudes towards tax compliance issues.

## 6. Conclusions

The empirical evidence in this study has shown that the threat of punishment is less likely to be effective in deterring people who already have strong intentions to comply with tax laws but more likely to increase their negative intentions to comply when threat of punishment is employed as one of the tools to reduce tax non-compliance attitudes. Their willingness to comply probably deteriorates because they are being threatened for things that they do not have any intentions to do. Therefore, the IRBM is suggested to carefully plan their strategy by using target policy in disseminating information to the right group of taxpayers such as salaried and self-

employed taxpayers in encouraging voluntary tax compliance in Malaysia. Since this study was dominated by salaried taxpayers, the key direction for future research is to explore self-employed taxpayers' perspectives on threat of punishment. It may provide interesting information to fully understand the possibility of taxpayers' changing attitudes depending on the avoidance opportunities available to them. Even with its limitations, this study has provided evidence that threat of punishment might activate the non-compliance attitudes in people who have strong intentions to comply.

## References

- Alm, J., Bahl, R., & Murray, M. (1990). Tax structure and tax compliance. *The Review of Economics and Statistics*, 72(4), 603-613.
- Alm, J., Jackson, B., & McKee, M. (1992). Estimating the determinants of taxpayer compliance with experimental data. *National Tax Journal*, 45(1), 107-114.
- Alm, J., & McKee, M. (1998). Extending the lessons of laboratory experiments on tax compliance to managerial and decision economics. *Managerial and Decision Economics*, 19(4/5), 259-275.
- Australian Tax Office. (2012). *Compliance program 2012-13*. Canberra: Australian Tax Office.
- Babbie, E. (2008). *The basics of social research* (4th ed.). Belmont, CA: Thomson Higher Education.
- Beck, P., Jon, D., & Jung, W. O. (1991). Experimental evidence on taxpayer reporting under uncertainty. *The Accounting Review*, 66(3), 535-558.
- Becker, G. (1968). Crime and punishment: An economic approach. *The Journal of Political Economy*, 76(2), 169-217.
- Braithwaite, V. (2003). Perceptions of who's not paying their fair share? *Australian Journal of Social Issues*, 38(3), 335-362.
- Braithwaite, V., Murphy, K., & Reinhart, M. (2007). Taxation threat, motivational postures, and responsive regulation. *Law and Policy*, 29(1), 137-158.
- Clotfelter, C. T. (1983). Tax evasion and tax rates: An analysis of individual returns. *The Review of Economics and Statistics*, 65(3), 363-373.
- de Leeuw, E. D. (2008). Choosing the method of data collection. In E. D. de Leeuw, J. J. Hox & D. A. Dillman (Eds.), *International handbook of survey methodology* (pp. 113-135). New York: Lawrence Erlbaum Associates.
- Department of Statistics Malaysia. (2001). *Population and housing census of Malaysia 2000*. Kuala Lumpur: Department of Statistics Malaysia.
- Dillman, D. A. (2007). *Mail and internet surveys* (2nd ed.). New Jersey: John Wiley and Sons.
- Etzioni, A. (1986). Tax evasion and perceptions of tax fairness: A research note. *Journal of Applied Behavioral Science*, 22(2), 177-185.
- Feinstein, J. S. (1991). An econometric analysis of income tax evasion and its detection. *The RAND Journal of Economics*, 22(1), 14-35.
- Fischer, C. M., Wartick, M., & Mark, M. M. (1992). Detection probability and taxpayer compliance: A review of the literature. *Journal of Accounting Literature*, 11(1), 1-46.
- Gilligan, G., & Richardson, G. (2005). Perceptions of tax fairness and tax compliance in Australia and Hong Kong - a preliminary study. *Journal of Financial Crime*, 12(4), 331-343.
- Hanno, D. M., & Violette, G. R. (1996). An analysis of moral and social influences on taxpayer behavior. *Behavioral Research in Accounting*, 8, 57-75.
- Hasseldine, J. (1993). How do revenue audits affect taxpayers compliance? *Bulletin for International Fiscal Documentation*, July/August, 424-435.
- Hasseldine, J., Hite, P., & Toumi, M. (2007). Persuasive communications: Tax compliance enforcement strategies for sole proprietors. *Contemporary Accounting Research*, 24(1), 171-194.
- Kirchler, E., & Wahl, I. (2010). Tax compliance inventory: Tax-i voluntary tax compliance, enforced tax compliance, tax avoidance, and tax evasion. *Journal of Economic Psychology*, 31(3), 331-346.
- Loo, E. C. (2006a). Determinants of individual taxpayers' compliance behaviour: Experience of the transition from pre to post self assessment in Malaysia. In M. Walpole & M. McKerchar (Eds.), *Further global challenges in tax administration* (pp. 201-225). Bath: Fiscal Publication.
- Loo, E. C. (2006b). Tax knowledge, tax structure and compliance: A report on a quasi-experiment. *New Zealand Journal of Taxation Law and Policy*, 12(2), 117-140.
- Loo, E. C., McKerchar, M., & Hansford, A. (2009). Understanding the compliance behaviour of Malaysian individual taxpayers using a mixed method approach. *Journal of Australasian Tax Teachers Association*, 4(1), 181-202.
- Loo, E. C., McKerchar, M., & Hansford, A. (2010). Findings on the impact of self assessment on the compliance behaviour of individual taxpayers in Malaysia: A case study approach. *Journal of Australian Taxation*, 13(1/2), 1-22.
- McKerchar, M., & Evans, C. (2009). Sustaining growth in developing economies through improved taxpayer compliance: Challenges for policy maker and revenue authorities. *eJournal of Tax Research*, 7(2), 171-201.
- Milliron, V. C., & Toy, D. R. (1988). Tax compliance: An investigation of key features. *Journal of the American Taxation Association*, 9(2), 84-104.
- Niemirowski, P., & Wearing, A. (2006). "Do Australian taxation office staff and compliant taxpayers identify with tax from the same perspective, or are there significant degrees of separation?". *Journal of Australian Taxation* 9(2), 191-171.

- Park, C., & Hyun, J. K. (2003). Examining the determinants of tax compliance by experimental data: A case of Korea. *Journal of Policy Modeling*, 25(8), 673-684.
- Salant, P. A., & Dillman, D. A. (1994). *How to conduct your own survey*. New York: John Wiley and Sons.
- Sandmo, A. (2005). The theory of tax evasion: A retrospective view. *National Tax Journal*, 58(4), 643-663.
- Skinner, J., & Slemrod, J. (1985). An economic perspective on tax evasion. *National Tax Journal*, 38(3), 345-353.
- Slemrod, J. (2004). The economics of corporate tax selfishness. *National Tax Journal*, 57(4), 877-899.
- Spicer, M. W., & Thomas, J. E. (1982). Audit probabilities and the tax evasion decision: An experimental approach. *Journal of Economic Psychology*, 2(3), 241-245.
- Trivedi, V. U., Shehata, M., & Lynn, B. (2003). Impact of personal and situational factors on taxpayer compliance: An experimental analysis. *Journal of Business Ethics*, 47(3), 175-197.
- Van Selm, M., & Jankowski, N. (2006). Conducting online surveys. *Quality and Quantity*, 40(3), 435-456.
- Verboon, P., & van Dijke, M. (2007). A self-interest analysis of justice and tax compliance: How distributive justice moderates the effect of outcome favorability. *Journal of Economic Psychology*, 28(6), 704-727.
- Witte, A. D., & Woodbury, D. F. (1985). The effect of tax laws and tax administration on tax compliance: The case of the U.S. individual income tax. *National Tax Journal*, 38(1), 1-13.
- Zikmund, W. G. (2003). *Business research method* (7th ed.). Ohio: Thompson.