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A Review of Factors Impacting Tax Compliance

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ABSTRACT

The aim of this paper is to identify the variables of tax compliance analysed by researchers from various countries and adapting them to the Việt Nam conditions to create a model to include factors that influence decision of tax compliance. Tax compliance has been studied in economics by analysing the individual decision of a representative person between compliance and non – compliance. In the research of tax compliance have been done many empirical studies that emphasized the impact of a wide variety of potential determinants of compliance. The most important determinants identified are: Industry factors including competition, profit margins, industry risk, growth rate, capital structure; Accounting factors including accounting knowledge, tax knowledge and accounting activities; Psychosocial factors including social norms, public spending, moral tax, perceived fairness; Tax administration factors including law enforcement, probabilities of detection, penalties, stability and transparency (fiscal fog), public services, unofficial costs; Economic factors including interest rates, inflation and tax rate.

Keywords: Tax compliance behavaiour, voluntary compliance, Corporate tax compliance.

1. Introduction

Tax compliance has always been a major concern for all tax administrations, more so in a self assessment environment where it is dependent on voluntary compliance. In Việt Nam, there is a dearth of empirical research on tax compliance in relation to the implementation of self assessment . One of the objectives for implementing self assessment is to increase voluntary tax compliance.

As such, in a tax system based largely on voluntary compliance, understanding factors that affect compliance amongst taxpayers is of vital importance. This paper integrates two important approaches, namely, the economic and behavioral approaches in identifying factors affecting tax compliance.

2. Literature review and proposed Theoretical Framework

A milestone was achieved when scholars framed the decision to comply or evade taxes as a decision under risk. Taxpayers either decide to declare their income honestly, paying their due as required and knowing the amount of money remaining with a sense of security, or they choose the risky option of evading taxes. In the case of being audited and fined they end up with less money compared to declaring their income honestly, if no audit takes place they possess a higher income than their honest counterparts. The economic theory of criminal behavior (Becker, 1968) states that legitimated punishments cause a significant deterrence effect and therefore the level of punishment and the probability of being detected are relevant factors in determining behavior. Two publications in the early 1970s by Allingham and Sandmo (1972) presented a model of tax behavior postulating that tax honesty increases with higher audit probability and severe fines.

Allingham and Sandmo's model assumes that individuals maximize their expected utility in order to decide whether to evade. The expected utility is given by the following equation:

$$E[U] = (1 - p)U(W - €X) + pU(W - €X - \pi(W - X))$$

where p is the audit probability, W is the actual income, € is the tax rate, X is the declared income, and π is the penalty rate. Allingham and Sandmo's (1972) neoclassical model of tax evasion is the starting point for almost all studies on tax compliance. In the real world, since in-depth tax audits are generally infrequent, fines often do not reflect the unpaid taxes, and criminal penalties are rarely applied, the model of Allingham and Sandmo suggests that rational individuals should declare an amount of taxable income close to zero. For this reason, lines of research have moved towards the manipulation of the model's variables or the introduction of factors that aim to make the model more realistic, such as psychosocial factors and others.

For these reason (1) "Tax compliance is a complex behavior and it seems that there is not a general consensus in this respect. Various theoretical models have been developed in literature that according to this theoretical models, there are a wide range of effective factors on compliance behavior of taxpayers". (Shaer Biabani and Adeleh Ramezani, 2011) and (2) Alm (1999) contended that "no single model can account for the enormous factors influencing tax compliance decision and submitted that other factors may well be relevant in explaining tax compliance behaviour” Based on the factors reviewed we propose variables that should be included in a model for predicting tax compliance. The factors are shown in the Figure 1. After pooling of data from previous studies (companies and individuals), it can crystallize the factors that have the most influence on tax compliance and may be created a mathematical model for tax compliance.

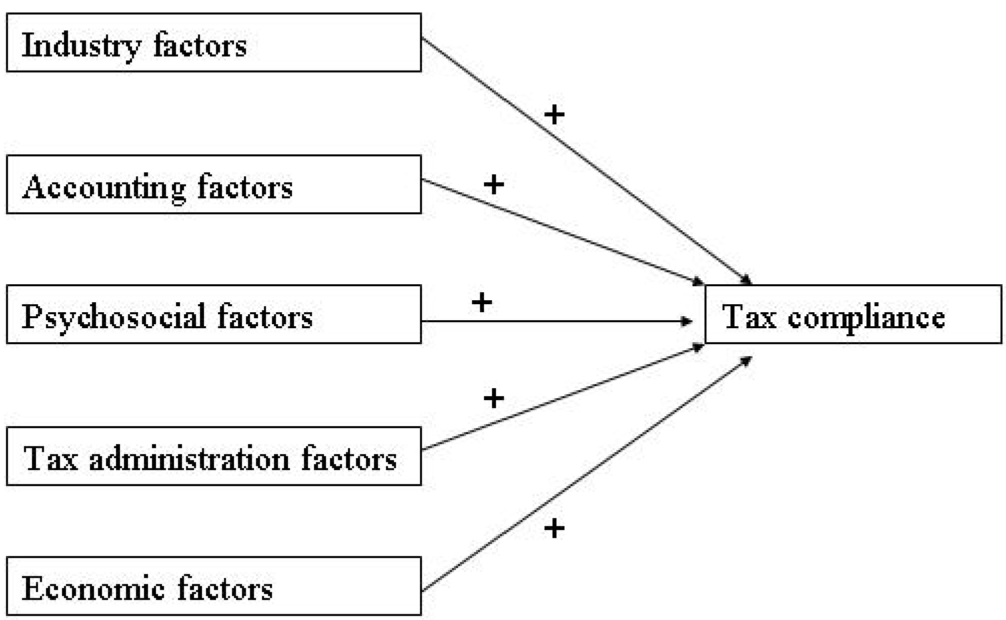

Figure 1. Factors impacting on tax compliance

1. Industry :
   - Competition
   - Profit margins
   - Industry risk
   - Growth rate
   - Capital structure

Source : BISEP Model (IMF, 2012; OECD, 2004); Bărbutămisu (2011); Lawrence D., (2011); OECD (2010); Wang (2010); Chau và Patrick Leung (2009); Emami A

(2004) see Shaer Biabani và Adeleh Ramezani (2011).

2. Accounting

Tax knowledge

Accounting knowledge

Accounting activities

Source : Wang (2010); Shaer Biabani et al, (2011); Massarrat-Mashhadi (2012); Sue (Siew Eng) Yong (2011); Mohd Rizal Palil (2010); Eriksen, K., and Fallan, L. (1996); Mohd Rizal Palil et al., (2011); Mohamad AA, Mustafa H, Asri M (2007). Mohd Rizal Palil at al., (2011a);

3. Psychosocial

Social norms

Public spending

Moral tax

Perceived fairness

Source : BISEP Model (IMF, 2012; OECD, 2004); Sue (Siew Eng) Yong (2011); Nicoleta Bărbutămisu (2011); Chan, C. W., Troutman, C. S., & O'Bryan, D. (2000); Chau, G., & Leung, P. (2009); Manaf, N. A. (2004); Mustafa, M. H. (1997); Oh Teik Hai et al., (2011); Benno Torgler (2011 : 7- 15); OECD (2010); Alm, J. & Torgler, B. (2006); Slemrod, J. (2007); Prince Kennedy Modugu et al., (2012).

4. Tax administration

Law enforcement

Probabilities of detection

Penalties

Stability and Transparency

Public services

Unofficial costs

Source : Nicoleta Bărbutămisu, 2011; Mohd Rizal Palil (2010); Shaer Biabani và Adeleh Ramezani (2011); Olivia Nghaamwa (2011); OECD (2012a); Okoye, Pius V.C. (2012); Marziana Bt. Hj. Mohamad (2010); Alabede et al., (2011); Lago-Peñas (2010); Anna Alon and Amy M. Hageman (2012); Dipl.-Vw. Salmai Qari (2012).

5. Economic

Tax rate

Interest rates

Inflation

Source : Allingham, M. G. and Sandmo, A. (1972); Pommerehne, W. W., Hart, A. and Frey, B. S (1994); Hyun, J. K. (2005); OECD (2004); Oh Teik Hai and Lim Meng See (2011); Martinez-Vazquez, J & Rider, M (2005); Wang (2010); FIAS (2004); Razieh Tabandeh et al., (2012); Mohd Rizal Palil and Ahmad Fariq Mustapha (2011).

Tax compliance

• Registration in the system

• Timely filing

• Correct returns

• Payment of taxation obligations on time

If a taxpayer fails to meet any of the above obligations then they may be considered to be non-compliant.

Source : OECD (2004; 2012); IMF (2012); John Obi Anyaduba (2012); Wang (2010).

3. Conclusions :

This paper proposes model for better understanding the Corporate tax compliance behaviour in Việt Nam. Theoretically, this proposed model will enrich the tax compliance literature for better understanding the compliance behaviour. In addition, the proposal is a single comprehensive model incorporating economic, political, social, psychological, cultural, environmental peculiarities and characteristic of tax administration as well as taxpayer in developing countries such as Việt Nam.

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