CHAPTER 1

1.0 Introduction

Tax morale and tax compliance have been widely researched, yet Slemrod's (1992 cited in Alasfour, Samy and Bampton, 2017, p. 126) classic question of why people pay taxes remains unanswered. Taxes are far from inevitable and individuals take a variety of actions to reduce their tax liabilities. Some are legal tax avoidance activities such as income splitting, postponement of taxes and tax arbitrage across income that faces different tax treatment. On the other hand, tax evasion consists of illegal and intentional actions taken by individuals to reduce their legally due tax obligations. Individuals can evade income taxes by underreporting incomes; by overstating deductions, exemptions or credits; by failing to file appropriate tax returns or even by engaging in barter (Alm, 2018).

For many years, the benchmark economic model of tax evasion has been the Allingham and Sandmo (1972 cited in Luttmer and Singhal, 2014, p. 149) model. This model assumes that taxpayers are rational actors who seek to maximise the value of their taxable income by assessing the benefits and the cost of compliance with the utility of tax non-compliance. Thus, taxpayers will be non-compliant when the expected penalty and probability of being caught are rather small compared to the utility gained by non-compliance. Consequently, the governments sought to ensure that the benefit of non-compliance is outweighed by the cost of noncompliance and increased the penalties and the perceived probability of detection of the noncompliant taxpayers (Horodnic, 2018). Despite the fact that tax administrators are concerned about enforcement, they also place a great deal of emphasis on improving tax morale, which means increasing voluntary compliance with tax laws and creating a social norm of compliance (Luttmer and Singhal, 2014). Torgler (2007 cited in Bilgin and Bilgin, 2016, p. 167) defined tax morale as the intrinsic motivation to pay taxes. Moreover, Torgler (2007

cited in Kondelaji, et al., 2016 p. 580) stated that when tax morale is high, level of compliance is relatively high. Therefore, it is important to investigate the determinants of tax morale to gain an understanding of tax compliance behaviour, so that appropriate measures can be taken to improve tax morale. Furthermore, Torgler (2004 cited in Bilgin and Bilgin, 2016, p. 168) indicated that tax morale measures taxpayers' attitudes while tax evasion measures taxpayers' behaviours.

1.1 Research Context and Issue

Tax morale measures taxpayer perceptions and attitudes towards paying and evading taxes, while tax compliance is the degree to which a taxpayer complies or fails to comply with the tax rules of their country. Research showed a significant correlation between tax morale and tax compliance in both developing and developed countries. Torgler (2011) indicated that tax morale is an important determinant of the shadow economy and therefore has an impact on tax evasion. Thus, understanding better what drives differences in tax morale across countries is a key element in understanding differences in tax compliance. It also offers a more grassroots perspective on tax systems than administrative and quantitative measures, such as tax to GrossDomestic Product (GDP) ratio (OECD 2013). In addition, more effort is needed to build a sustainable taxpaying culture. Many individuals indeveloping countries pay indirect taxes but the number of registered taxpayers who file and pay taxes in most developing countries is very low (OECD, 2019). In Pakistan for example, there is an ongoing struggle with low tax collection. In 2015, tax collections amounted to 11% of Pakistan's GDP and has seen a downward trend for the last two decades. Low revenue collections have been reflected in the large federal government deficit which has fluctuated around 6% of GDP over the past decade. Therefore, it is important to investigate the factors that influence tax morale and find

out what prevents people from voluntary complying with their tax obligations so that tax collection efforts can be improved (Cyan, Koumpias, Martinez-Vazquez, 2016).

According to the OECD (2019), tax morale is a vital aspect of the tax system, as most tax systems rely on the voluntary compliance of taxpayers for the bulk of their revenues. Therefore, improving tax morale holds the potential to increase revenues with little effort. Consequently,a deeper understanding of the factors that influence taxpayers' perceptions of the tax system and willingness to pay taxes is the starting point for improving tax morale. Similarly, Bilgin and Bilgin (2016) noted that the determinants of tax morale are needed to be investigated for understanding of tax compliance, since there is limited work on the issue in existing literature. Likewise, Feld and Frey (2002) pointed out that most studies viewed tax morale as a black box without considering how it might arise or how it might be maintained.

Furthermore, tax non-compliance continues to represent a core issue for many governments around the world. Tax evasion reduces tax collections, thereby affecting taxes that compliant taxpayers face and public services that citizens receive. Beyond these revenue losses, evasion creates misallocations in resource use when individuals alter their behaviour to cheat on their taxes, such as in their choices of hours to work, occupations to enter and investments to undertake. Its presence requires that government expends resources to detect non-compliance, to measure its magnitude and to penalize its practitioners. Non-compliance alters the distribution of income in arbitrary, unpredictable and unfair ways. Evasion may contribute to feelings of unjust treatment and disrespect for the law. It affects the accuracy of macroeconomic statistics. More broadly, it is not possible to understand the true impacts of taxation without considering tax evasion.

1.2 Rationale

This research will shed light on the determinants of tax morale in order to understand tax compliance behaviour of individuals. It is argued that tax morale is concerned with why people do not evade. There has been much in common between tax morale and tax compliance. Tax compliance is an observable action; that is most people pay their taxes. Tax compliance is not only a function of tax ratios and probability of detection, but also a function of an individual's willingness to comply with and to evade. As Torgler (2007 cited in Bilgin, 2014, p.61) pointed out, level of tax compliance is relatively high when tax morale is high; therefore tax morale is needed for providing on an account of the puzzle of tax compliance. For this reason, the study will investigate the determinants of tax morale for a much more comprehensive understanding of tax compliance (Bilgin, 2014).

Moreover, an empirical study by Kondelaji, et al. (2016) analysed the effects of the most important determinants of tax morale in Iran based on social psychology theories. Social psychology models attempt to explain and anticipate human behaviour by examining the underlying attitudes, norms and beliefs. The central point of these models is if the individual's behaviour is understood, then it may be possible to understand and predict attitudes toward taxpayer compliance decisions. Similarly, Cyan, Koumpias, Martinez-Vazquez (2016) examined the determinants of tax morale in Pakistan, a country that has struggled with low tax effort for many years. It was established that knowledge of the determinants of tax morale can guide tax enforcement to achieve more cost-effective interventions and maximize the impact of the tax authority's communication strategy.

1.3 Research Question

In light of the discussion above, it is apparent that some individuals comply with their tax obligations, while other individuals evade tax. Since tax morale is seen as a major factor in understanding tax compliance behaviour, this research has one central question. The researcher seeks to find out "what are the determinants of tax morale?" According to Alasfour, Samy and Bampton (2017), tax morale measures an individual's willingness to pay taxes, that is 'the moral obligation to pay taxes' or 'the belief that paying taxes contributes to society'.

1.4 Aim and Objectives

Tax morale is considered as a set of underlying motivations for tax compliance. The aim of this research is to analyse the major determinants that influence tax morale such as trust in the government, religiosity and demographic and socio-economic factors.

Objectives:

1. To evaluate trust in the government as a determinant of tax morale.

2. To evaluate religiosity as a determinant of tax morale.

3. To evaluate demographic and socio-economic factors as determinants of tax morale.

1.6 Dissertation Structure

The dissertation entails five chapters as shown in the dissertation map in Figure 1.2 below. On completion of the first chapter, the researcher will conduct a review of existing literature related to tax morale and tax compliance in the second chapter in order to achieve the research objectives stated above. The third chapter will comprise of the research design and methodology used in the study. Subsequently, the fourth chapter will reveal the findings and analysis of the study completed on tax morale. Ultimately, the fifth chapter will present the conclusion of the study, provide recommendations and discuss the limitations of the study, as well as future research.

Figure 1.2 Undergraduate Major Project Dissertation Map
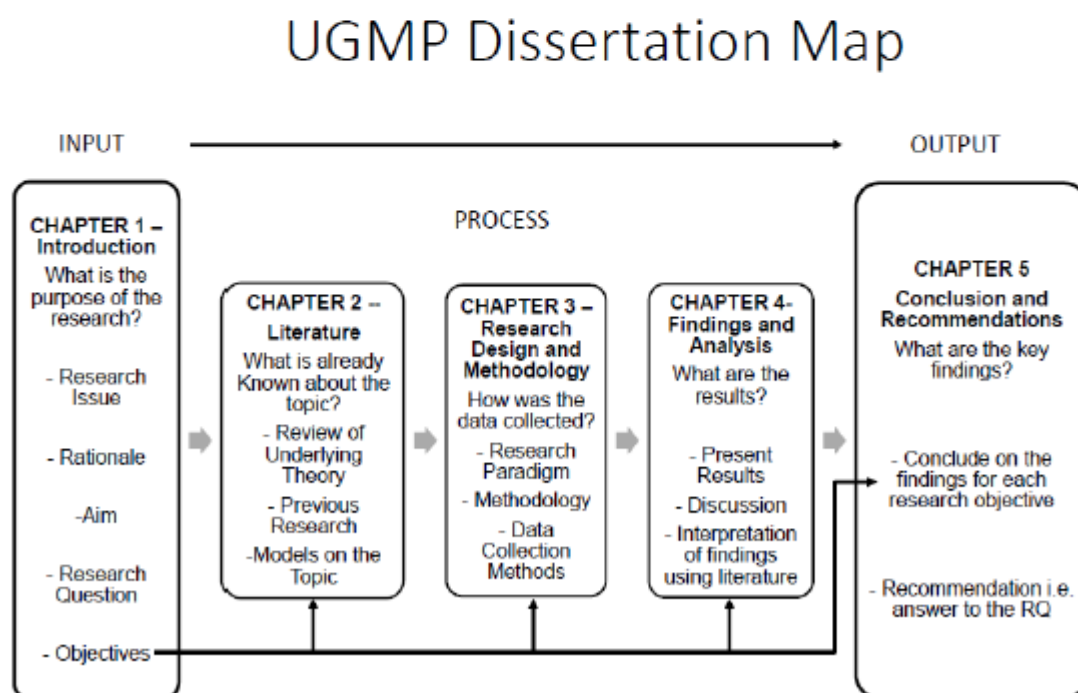
Source: Adapted from Samuel, 2019