

# Understanding Tax Morale and Tax Compliance of SMEs: A Case of Tax Practitioner

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## Abstract

This study aimed to analyze tax morale and tax compliance among the small medium enterprise (SME) from the tax practitioners' perspective. Tax morale is defined as the intrinsic motivation to pay taxes arising from the moral obligation to pay taxes or the belief in contributing to the society. To achieve these goals, high tax morale is required to achieve a high degree of tax compliance. The general objective of this study is to determine the level of tax morale and tax compliance of SME taxpayers. In addition, the study also investigates the effect of tax morale towards tax compliance and the significant relationship between tax morale and tax compliance among the SME taxpayers. 200 questionnaires were distributed to the tax practitioners that randomly selected in Kuala Lumpur. Descriptive and correlations analysis were used to analyze the data. The result shows that there are a number of significant relationships between tax morale and tax compliance. The study recommended that there is a need to provide strong taxpayers services from the tax authority and tax firms for understanding the tax policy and regulations in Malaysia.

**Keyword** Attitude, culture, tax-compliance, tax-knowledge, tax-morale

## INTRODUCTION

Taxation is one of the most volatile subjects in governance both in the developing and developed nations. Tax refers to a "compulsory levy by a public authority for which nothing is received directly in return" (James & Nobes, 1992). In other words, a tax is an imposed levy by the government against the income, profits, property; wealth and consumption of individuals and corporate organization to enable government obtain the required revenue to provide basic amenities, security and well-being of the citizens. According

by Nightingale (2001) defined the tax as compulsory contribution, imposed by government and while taxpayers may receive nothing identifiable in return for their contribution.

In year 2001, the Malaysia government introduced self-assessment system (SAS) scheme. SAS was fully implemented in stages by the government; for companies in year 2001, business, partnership and cooperatives in year 2003 and individual in year 2004. Taxpayers are expected to fill a tax assessment form to determine their taxable income. Here, the intrinsic motivation to pay tax (tax morale) will determine the level of compliance with reporting requirements. It means that the taxpayers files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the law. In other words, high tax morale is required from the taxpayers in order to achieve a high degree of tax compliance. Based on the traditional model of tax compliance by Allingham and Sandmo (1972), taxpayers choose how much income to report on their tax returns by solving standards expected utility maximization problem that trade off the tax savings from underreporting true income against the risk of audit and penalties for detected non compliance.

Small and Medium Enterprise (SME) are subjected to income tax payable either as individuals or as corporate taxpayers depending on the business establishment. The taxation of both individuals and corporate businesses is governed by the Income Tax Act (ITA) (Malaysia) 1967. Business taxpayers are required by law to file an annual tax return correctly (Section 77 and 77A; ITA 1967), to keep sufficient records and documentations (Section 82 and 82A; ITA 1967) and to observe other tax related requirements (Section 107, 107B, 107C and 108; ITA 1967). Compliance to the regulatory requirements is mandatory in nature, placing an enormous burden and cost upon the business sectors. Largely, international experiences often indicate the difficulties faced by the SMEs in managing government laws and regulations (Fernandez & Lynne, 1998).

For the majority of taxpayers, tax practitioners were their sole source of support. The tax practitioners are people that taxpayers can trust to keep them on the right side of the law. Having the honest tax practitioners or adviser was the highest priority. Tan (1999) was reported that New Zealand suggesting the core important contribution is the tax practitioners make to taxpayers as a whole to give them confidence that their tax matters are under control and their tax paying behaviour is lawful. Collins et al., (1990) and Hite and McGill (1992) indicated similar conclusions in their work in United States. ME businesses interested in tax minimization were open to have tax practitioners who understand both low and high risk strategies. Marshall et al., (1998) conclude that diversity occurs among Australian tax practitioners in the ethical stances that they take. Tax practitioners appear to be successful in marketing their skills in a way that is suitable to the clients' needs or the other hand.

Based on the tax morale literature, the entire researcher focused on tax morale of individuals and only Alm and McClellan (2012) touched on firm perspective. They examined main measures of tax compliance by comparing

Business Environment and Enterprise Performance Survey (BEEPS) and World Enterprise Survey (WES) data. However, there are not any researches has pointed out for Small and Medium enterprises (SME). Therefore this study enriches the existing literature on tax morale and tax compliance study in Malaysia. The aim of this study is to determine the level of tax morale and tax compliance of SME taxpayers from the tax practitioners' perspective. This study also investigates the effect of tax morale and the significant relationship towards tax compliance among SME. Psychology theories of tax compliance are used in this study to measure the tax morale based on the psychology factors which include tax knowledge attitude social and culture norms towards tax compliance. This paper is organized as follows; reviews of literatures, research methodology and discussion of finding. The last section includes some recommendations and direction for future research.

## **LITERATURE REVIEW**

### **Tax Morale**

Tax morale is defined as the "intrinsic motivation to pay taxes". Torgler (2002) and Fred (2003) stress its relevance to understanding the high observed level of compliance. The authors reported have three key factors are important in understanding tax morale which are moral rule and sentiments, fairness and the relationship between taxpayers and government. Tax morale has not been very widely discussed in the literature (Torgler, 2007). Nevertheless, moral and cultural motivations of taxpaying behavior are playing an effective role on taxpayers' compliance behavior. Some preliminary tax morale research was conducted during the 1960s by the Cologne School of Psychology, that tried to narrow the bridge between economics and social psychology by emphasizing that economic phenomena should not only be analyzed from the traditional neoclassical point of view but also from social psychology perspective.

Tax morale is closely referred to the taxpayers' ethic. Song and Yarbrough (1978) defined as "the norms of behavior governing citizens as taxpayers in their relationship with the government". Besides that, tax morale is likely to be affected by the nature of the fiscal exchange between taxpayers and government. Feld and Frey (2002) argue that the way in which government treats taxpayers. For example, is the exchange viewed by taxpayers as fair or unfair, it will affect taxpayers' morale. In particular, tax morale as an important and integral attitude that was related to tax non compliance. If the taxpayers feels or belief that tax system is unfair, that is having a high tax burden, moral cost to behave honestly will decrease and tax evasion can be seen as sort of resistance against tax system. Therefore, the tax practitioners or tax authority are play the important role for increasing the value of tax morale and tax compliance.

## Tax Knowledge

Previous researches indicate that tax knowledge is essential in order to increase the level of tax compliance (Richardson, 2006; Kirchler *et al.*, 2008). Hence, it is very important to have knowledgeable and competent taxpayers. Park and Hyun (2003), suggest that tax education is one of the effective tools to induce taxpayers to comply more. In other words, taxpayers are more willing to comply if they understand the basic concept of taxation. For example, the level of tax compliance in Japan is high. The main reason for the high tax compliance in Japan is because of the efforts made by the Japanese National Tax Administration (NTA). The Self-Assessment System was introduced in 1947 and plays an important role in the taxation learning process to taxpayers. In addition, tax knowledge will also reduce the potential for evasion. In a cross country study by Richardson (2006) towards 45 countries in the world, he found that education in general has a negative relationship with tax evasion, where the tendency to evade tax reduces with the level of education.

However, it is still questionable whether this general level of education will increase tax compliance. This is because in a study by Loo and Ho (2005) toward a group of salaried individuals in Melaka, Malaysia, they found that the taxpayers' competency level is quite low even though most of them have tertiary education. This is an alarming situation because it might impact on their readiness to exercise appropriate compliance under the new self-assessment system (SAS). In a study by Junainah (2002) towards the implementation of SAS among individual taxpayers in Kota Kinabalu, Malaysia, she also finds that most of the taxpayers were unwilling to participate in SAS because of the burden that they have to face, especially in terms of completing tax return and calculating income tax payable. They were comfortable with the simplification of the formal system. In his book entitled "Malaysian Taxation under Self Assessment" Kasipillai (2007) emphasizes that knowledge about tax law is assumed to be of importance for preference and to determine the acceptance of the Self Assessment System (SAS). Based on the previous literatures, the present study is trying to test the following hypotheses:

$H_1$ : *There is significant relationship between tax knowledge and tax compliance*

## Attitude, Social and Culture Norms

Attitude defined as an individual degree of like or dislike. Several researchers conducted studies about citizens' attitudes on tax morale in various countries. Torgler and Friedrich (2005) found that religiosity raise tax morale in more than 30 countries at the individual level. According to Ajzen's (1991) Theory of Planned Behaviour, attitude relates to one's own personal views about behaviour. In taxation, taxpayers' attitude may be defined as positive or negative views of tax compliance behaviour. The outcome of positive views is tax compliance and negative view is tax non compliance. Erikson and Fallan (1995) reported that when the tax attitudes towards taxation are improved,

this will in turn increase tax compliance and reduce the tax evasion. It means when the taxpayers who are have the negative attitude will having lack responsibility towards tax compliance. Theoretically, Ajzen (1991), Fischebein and Ajzen (1975) and Oskamp (1991) have indicated that attitude is a partial indication of behaviour. Attitude towards an event, object, function or person may be favourable or unfavourable.

Social and culture norms are believed to be one of the factors that will affect the tax compliance of the taxpayers. Cultural norms are behaviour patterns that are typical of specific groups. Such behaviours are learned from parents, teachers, peers, and many others whose values, attitudes, beliefs, and behaviours take place in the context of their own organizational culture. Alm and McClelland (2012) suggested that the social norm of tax compliance can be influenced by group communications. In a study done by Wenzel (2005), reported that social norms affect tax compliance decision. Such cultural experiments on tax compliance have been conducted in several countries. Alm *et. al.* (1995) use experimental methods to explore the role of social norm in Spain and the United States. In addition, Cummings, Martinez-Vaz-quez, McKee and Torgler (2004) combine experimental and survey data from the United States, Botswana and South Africa to investigate whether cross cultural differences can explain tax compliance behaviour across these countries. Their results indicate that the observed differences in tax compliance behaviour and tax morale can be explained by differences in the fairness of tax administration, in the perceived equity of the fiscal exchange and attitude towards the respective government across the countries. Therefore, the second and third hypotheses as follows:

- H<sub>2</sub>: *There is significant relationship between attitudes and tax compliance*
- H<sub>3</sub>: *There is significant relationship between social and culture norms towards tax compliance*

## 1.1 The Concept of Tax Compliance

Tax compliance is defined as the degree to which a taxpayer complies or fails to comply with the rules and regulations of their company. Tax compliance also is complex behavioral issues and investigates requires to use of a variety of methods and data sources. Brown and Mazur (2003) classified tax compliance is multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance and reporting compliance. According to Roth *et. al.* (1989), compliance with reporting requirement means that the taxpayers files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the Internal Revenue code, regulations and court decision applicable at the time the return is filed.

Tax compliance may be seen in terms of tax avoidance and evasion. The two are conventionally distinguished in terms of legality with avoidance

referring to legal measures to reduce tax liability and evasion as illegal measures. Abrie and Doussy (2006) conducted a research on the tax function in SME manufacturing which is in Gauteng Province in South Africa. They found that the main problems is administering government taxes and suggested for considering to reduce the number of taxes for sole proprietorship. SMEs are generally non-professional companies and they are more likely to be run by an individual. Low tax compliance is a matter serious concern in many developing countries. Therefore, the focus of this study is to investigate the tax morale affect tax compliance among the SME from the tax practitioners perspective.

## RESEARCH METHODOLOGY

Data were collected from respondents consisting of tax practitioners in Kuala Lumpur who are doing the tax audit and tax compliance for SME business. The list of tax practitioners' officers was obtained from the Inland Revenue Board (IRB) website. This research has been carried out through questionnaires. The questionnaire is adapted and adopted from Niemirowski and Wearing (2003). According to Sekaran (2003), a questionnaires survey is a formulated written set of questions to which respondents' records their answers, usually from clearly defined alternatives. 200 questionnaires were distributed to tax practitioners, but only 121 agreed to participate (60.5 percent respond rate). There are four operational variables which comprise one dependent variable and three independent variables as shown in Table 1:

**Table 1** Variables Measurements

Variables	Measurement
<b>Dependent Variable</b> Tax Compliance Evidence from Tax Practitioners	The level of tax compliance
<b>Independent Variable</b> Tax Knowledge Attitude Social and Culture Norms	The level of tax knowledge The level of tax related of attitude The level of tax related of social and culture norms

The validity of an instrument is being able to measure what it is supposed to measure, while reliability of an instrument on the other hand is being able to measure whatever it is to measure over and over again (Salkind, 2004). The Cronbach's alpha coefficient of scale stipulated a standard of above 0.70 for reliability test. The reliability ratios for this study is 0.827 shed that all the research questions in the questionnaire hang together and have internal consistency in solving distress problems.

## RESULTS AND DISCUSSION

As indicated above, the aims of this study are three. Firstly, to analyses the level of tax morale and tax compliance among the SME taxpayers. Secondly is to investigate the effects of tax morale towards tax compliance among SME. Third, to examine the relationship between tax morale and tax compliance of SME based in the view by tax practitioners.

The demographic information on the respondents as presented in Table 2 indicates that 54.5% of the respondents were female leaving 45.5% as male and that the age grouping of majority of the respondents falls between 31 and 50 years (31.4%). The position of the company, Table reveals that about 31.4% of the respondents were tax agent and 20.7% were team manager. Further information on respondents' profiles is summaries as follows:

**Table 2** Respondents Profile

Categories	Information	Frequencies	Percentages (%)
<b>Gender</b>	Male	55	45.5
	Female	66	54.5
<b>Age</b>	20 – 30	24	19.8
	31 – 40	38	31.4
	41 – 50	38	31.4
	51 and above	21	17.4
<b>Position in the company</b>	Owner	14	11.6
	Team Manager	25	20.7
	Tax Agent	38	31.4
	Auditor	20	16.5
	Others	24	19.8
<b>Type of audit firm</b>	Big Four	15	12.4
	Medium	73	60.3
	Small	29	24.0
	Others	4	3.3
<b>No of Client</b>	0 – 50	6	5.0
	51 – 100	26	21.5
	101 – 250	44	36.4
	251 – 1000	32	26.4
	1001 and above	13	10.7

### Descriptive Analysis

Tax practitioner's act as taxpayers advisor, risk takers and risk minimizes and as mediators. It is not surprising that SME taxpayers turn to tax agents for assistance. Table 3 present the level of tax compliance of SME either complies or fails to comply the rule and regulation of the tax system. The overall results shows that the tax practitioners are "Agree" (2.5454) which is their clients are more comply with all the requirement of tax law and aware of the fine or penalty if the late submission of tax return. However, they also facing the problem

which is the clients did not submitted their tax return on time or before 30 June every year because of the technical problem such as the improper records of the transaction of financial reporting. The results indicated that the mean is 2.6612 (agree) on “Clients didn’t submitted all their tax return accordingly (30<sup>th</sup> June 2011)”.

**Table 3** Level of Tax Compliance

No	Items	Mean	Std. Deviation
1	All of your clients understand about tax law. i.e. rates of tax, filing, paying date and others	2.5289	1.11859
2	All of your clients aware of the tax fine and penalty	2.3802	0.99378
3	Clients have followed all the rules and regulations when preparing their financial statement and submission tax return	2.6281	1.01761
4	Clients didn’t followed all the rules and regulation when preparing their financial statement and submission tax return	2.4959	0.90484
5	Clients have submitted all their tax return accordingly (30 <sup>th</sup> June 2011)	2.5785	1.04684
6	Clients didn’t submitted all their tax return accordingly (30 <sup>th</sup> June 2011)	2.6612	1.07667
	<b>Average</b>	<b>2.5454</b>	<b>1.02638</b>

Likert scale 1 to 5, 1 = Strongly Agree, 5 = Strongly Disagree

Table 4 present the level of tax morale which involved three variables which are tax knowledge, attitude and cultural and social norms. As mention early, tax morale is closely related with the taxpayers’ ethics. If the taxpayers feel the tax system is fairness then the tax compliance will be increasing. Firstly, in tem of level of tax knowledge, the highest mean is 2.5207 (Agree) which is “Clients that have low education will be less responsible towards tax compliance” followed by “Low awareness about the importance of tax compliance are resulted from clients low knowledge” which is 2.3802. The overall results indicated that their clients are aware the important of tax knowledge to calculate their tax return and improved the tax compliance which is 2.3294 (Agree).

Secondly, in term of attitude, the results reported that the highest mean is 2.4298 (Agree) which is “Clients that have negative attitudes or behaviour will be less responsible towards tax compliance” followed by “High awareness about the importance of tax compliance are resulted from clients positive attitudes or behaviour” which is 2.4132. From the results, the tax agents’ belief that the attitude will give the impact to the tax compliance and responded favourably or unfavourably to tax cheats.

Third, in term of cultural and social norms, the highest mean is 2.5667 (Agree) which is “Clients that have unethical social and cultures norms will be less responsible towards tax compliance” followed by “Low awareness about the importance of tax compliance are resulted from clients unethical social and cultures norms” which is 2.5372. The tax agents’ agreed that if the tax system is justice and fairness, the taxpayers be able to pay tax and avoid evading the tax payment. The overall results showed that the average level is 2.4221 which are agreed.

**Table 4** Level of Tax Knowledge, Attitude and Cultural and Social Norms

No	Items	Mean	Std. Deviation
<b>Level of Tax Knowledge</b>			
1	Clients who have higher tax knowledge correlates with a higher tax morale	2.2149	0.83872
2	Clients who have lower tax knowledge correlates with a lower tax morale	2.2893	0.83104
3	Clients that have high education will be more responsible towards tax compliance	2.2727	0.86603
4	Clients that have low education will be less responsible towards tax compliance	2.5207	0.93184
5	High awareness about the importance of tax compliance are resulted from clients high knowledge	2.2893	0.86060
6	Low awareness about the importance of tax compliance are resulted from clients low knowledge	2.3802	0.92427
7	Clients level of tax knowledge will determine their level of tax morale	2.3388	0.95353
<b>Average</b>		<b>2.3294</b>	<b>0.76363</b>
<b>Level of Attitude</b>			
1	Clients who have positive attitudes or behaviour correlates with a positive tax morale	2.1983	0.78124
2	Clients who have negative attitudes or behaviour correlates with a negative tax morale	2.3884	0.91626
3	Clients that have positive attitudes or behaviour will be more responsible towards tax compliance	2.3719	0.95858
4	Clients that have negative attitudes or behaviour will be less responsible towards tax compliance	2.4298	0.93832
5	High awareness about the importance of tax compliance are resulted from clients positive attitudes or behaviour	2.4132	1.03012

6	Low awareness about the importance of tax compliance are resulted from clients negative attitudes or behaviour	2.3719	0.94103
7	Clients level of attitudes or behaviour will determine their level of tax morale	2.2893	1.09877
	<b>Average</b>	<b>2.3518</b>	<b>0.95204</b>
	<b>Level of Social and Cultural Norm</b>		
1	Clients who are surrounding with an ethical social and cultures norms correlates with an ethical tax morale	2.3140	0.77495
2	Clients who are surrounding with an unethical social and cultures norms correlates with an unethical tax morale	2.5124	0.78651
3	Clients that have ethical social and cultures norms will be more responsible towards tax compliance	2.4793	0.87654
4	Clients that have unethical social and cultures norms will be less responsible towards tax compliance	2.5667	1.04305
5	High awareness about the importance of tax compliance are resulted from clients ethical social and cultures norms	2.3223	0.90568
6	Low awareness about the importance of tax compliance are resulted from clients unethical social and cultures norms	2.5372	1.06490
7	Clients level of social and cultures norms will determine their level of tax morale	2.2231	0.86108
	<b>Average</b>	<b>2.4221</b>	<b>0.90539</b>

Likert scale 1 to 5, 1 = Strongly Agree, 5 = Strongly Disagree

### Correlation Analysis

Table 5 depicts the correlation between the levels of tax moral towards tax compliance. Based on the results from the tax agents' perspective all independent variable have a significant relation with tax compliance. Each variable is perfectly correlated. First, tax knowledge is positive related to tax compliance with the correlation coefficient of 0.278 and there is a p value less than 0.01 which is 0.002. This significant value shows that the probability of this correlation is moderate. The results indicated that have relationship between tax knowledge and tax compliance. This is consistent with the previous study Richardson, (2006) and Kirchler *et al.*, (2008). Therefore, the alternate hypothesis ( $H_1$ ) is accepted.

Second, in term of attitude also showed a significant relationship with tax compliance which is p value is less than 0.01 (correlation value 0.313). It

can concluded that the attitude of taxpayers play the important elements to measure the tax compliance. The tax agents' agreed that the level of attitudes of taxpayers will be affecting the level of tax compliance. According to Erikson and Fallan (1995) reported that when the tax attitudes towards taxation are improved, this will in turn increase tax compliance and reduce the tax evasion. Therefore, the alternate hypothesis ( $H_2$ ) is accepted.

Third, in term of cultural and social norms shows the significant value for this correlations coefficient is less than 0.01 which is 0.000 (correlation value 0.350). Therefore, it can be concluded that there is a significant relationship between cultural and social norms towards tax compliance. When the SME taxpayers voluntary acceptance of decision made by the authorities, they strongly applied the rule and regulations of tax system and responds to the tax compliance. This is consisted with the previous study Wenzel (2005) reported that social norms affect tax compliance decision. Therefore, the alternate hypothesis ( $H_3$ ) is accepted.

**Table 5** Spearman's Rho Correlations

		Mean Tax Compliance	Mean Tax Knowledge	Mean Attitude	Mean Social & Cultural Norm
<b>Mean Tax Compliance</b>	Correlation Coefficient	1.000	.278**	.313**	.350**
	Sig. (2-tailed)	.	.002	.000	.000
	N	121	121	121	121
<b>Mean Tax Knowledge</b>	Correlation Coefficient	.278**	1.000	.676**	.635**
	Sig. (2-tailed)	.002	.	.000	.000
	N	121	121	121	121
<b>Mean Attitude</b>	Correlation Coefficient	.313**	.676**	1.000	.668**
	Sig. (2-tailed)	.000	.000	.	.000
	N	121	121	121	121
<b>Mean Social &amp; Cultural Norm</b>	Correlation Coefficient	.350**	.635**	.668**	1.000
	Sig. (2-tailed)	.000	.000	.000	.
	N	121	121	121	121

\*\* . Correlation is significant at the 0.01 level (2-tailed).

## CONCLUSION

Tax compliance is a complex decision that is motivated by a variety of factors. The threat of detection and punishment is clearly a factor and evidence from a variety of sources supports the proposition that increased enforcement leads to increase compliance. This study is undertaken primarily to determine the level of tax morale and tax compliance and also to investigate the relationship between tax knowledge, attitude and cultural and social norm towards tax compliance. In summary, based on descriptive analysis indicate that tax morale have strongly affected to tax compliance. The overall results show that the tax agents agreed all the SME taxpayers followed all the rules and regulations and awareness of the penalty of late payment. The tax agents also agreed that if high level of tax knowledge, good attitude and good ethical social and cultural norms will highly increase the level of tax compliance.

Based on the correlations finding has found a significant positive relationship between tax morale and tax compliance. Based on the psychology theories of tax compliance assume that psychology factors such as moral and ethical concerns are important to taxpayers and changing individual attitudes towards tax system. It concluded that if tax morale is high, tax compliance will be relatively high. Taxpayers may follow laws they know or trust to produce good results. According to Ahmad (2007) clarified that there are significant difference between taxpayers who has tax knowledge and taxpayers who did not have tax knowledge may have insufficient knowledge to interpret and understand the tax law. In general, tax compliance may be view in term of tax avoidance and evasion. Therefore,  $H_1$ ,  $H_2$  and  $H_3$  were accepted.

This study has a number of limitations. In the first place, the focus of this study was only based on the tax practitioners' perspective and did not make the comparison with the SME itself. This study relied on self-reported behaviour of the taxpayers like most compliance researchers. Besides that, this study only considered influence of SME tax morale towards tax compliance. This study, however, cannot be generalized to all taxpayers, since it is only being conducted to the SME taxpayers in Kuala Lumpur. In addition, it is interesting if in the future, further research could be conducted to test on the relationship between the degrees of government regulations that seek to increase taxpayers' level of tax compliance. It also very beneficial if the study could be further conducted towards companies to observe their level of tax knowledge and responsibilities.

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