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The Influence of Education on Tax Avoidance and Tax Evasion²

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Abstract

This study evaluates the influence of education on tax compliance among undergraduate students in Malaysia. The survey considers existing literature in the field of education and ascertains whether education can influence the respondents' compliance behaviour. The statistical findings confirm the prevalence of a relationship between education and tax compliance. This relationship is generally consistent, particularly so to the questions relating to general avoidance and personal avoidance. There is an improvement in personal tax compliance among students especially among females after one semester of pursuing a preliminary taxation course. It is suggested that universities providing courses in social science as well as business, management and accounting studies should offer the preliminary taxation course as a core subject to all their students.

I. INTRODUCTION

Past research has indicated that tax evasion, especially in small amounts, is not viewed as being morally wrong or considered as a serious crime (Song and Yarbrough, 1978; Westat, 1980; Yankelovich, Skelly and White, 1984). Several research findings have reported a positive relationship between taxpayers' view of tax evasion as wrong and tax compliance behaviour (Scott and Grasmick, 1981; Thurman, John and Riggs, 1984; Kaplan, Reckers and Roark, 1988; Klepper and Nagin, 1989; Grasmik and Bursik, 1990). Basic principles of taxation

In New Zealand, Lin and Carrol (2000) examined the linkages between an increase in tax knowledge on perceptions of fairness and tax compliance attitudes by using students enrolled in an introductory taxation course in a tertiary institution. Their results indicated that an increase in tax knowledge did not have a significant impact on perceptions of fairness and tax compliance attitudes. This result is inconsistent with the findings of other researchers (see Crane and Nourzad, 1990) who found a positive linkage.

II. LITERATURE REVIEW

The literature section deliberates on the definition of tax avoidance and tax evasion followed by a review of the theoretical framework surrounding tax compliance.

Tax avoidance and tax evasion

Tax resistance takes two basic forms: evasion and avoidance. Evasion of tax is immoral as it is illegal (Brown, 1983). Tax evasion is meant to be deliberate acts of non-compliance resulting in payment of lower taxes than are actually owed. Therefore, not paying 'ones' lawful share of tax is evasion of income. On the other hand, tax avoidance, which denotes the taxpayers' ingenuity to arrange his affairs in a proper manner so as to reduce the incidence of tax, is legal. As long as the provisions of the law are not violated and transactions *bona fide*, any attempt to minimize tax is acceptable.

The term non-compliance encompasses both intentional evasion and unintentional non-compliance which is likely due to calculation errors and inadequate understanding of tax laws. A particular taxpayer may intentionally evade some of his or her obligations while intentionally being non-compliant in other aspects. Intentional non-compliance to reduce or eliminate the amount of tax payable requires some measure of understanding of the tax system. While there may not be a one to one correlation, it may be reasonable to assume that the greater the understanding of the tax system, the greater is one's ability to 'hookwink' the system. If so, there is a direct relationship between understanding the tax system and the probable propensity to evade the full payment of tax.

Evasion can take place in a number of ways. Individuals may choose to underreport their true income. They may also overstate adjustments in moving from Total Income to Adjusted Gross Income (AGI), or claim excessive deductions from AGI when computing taxable income. Kolm (1973) stated that some degree of tax evasion was expected and tolerated. The author (Kolm) estimated that one-third of the French income tax base fails to be reported to the revenue authorities.

Taxation is a social phenomenon that comprises of political, social and legal aspects and can be influenced by attitudes. Thus, incotional

has serious consequences to Governments as it not only cause losses in current revenues but it fosters a threat to voluntary compliance.

Theoretical framework on tax compliance

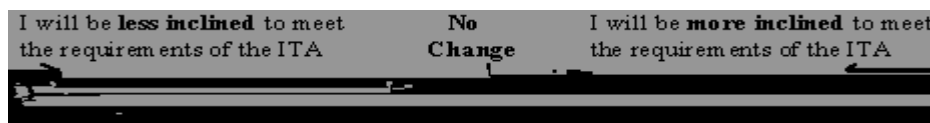
Achieving tax compliance is costly for both tax authorities and taxpayers. Tax audit and investigation is obviously costly to tax authorities (Allingham and Sandmo, 1972). Compliance is also costly to taxpayers, who must keep records as well as consult tax professionals and this is particularly true under a self-assessment system. Malaysia introduced a self-assessment tax system in stages commencing with companies from year of assessment 2001. In 2004, it would apply to all categories of taxpayers, including individuals. Slemrod and Sorum (1984) suggested that the compliance cost of managing individual income taxes in developed countries is between five and seven percent of revenue raised. According to Henry (1983), perfect compliance to tax law is not a rational objective for public policy.

Most taxation systems in the world reveal that taxation authorities employ a mixture of enforcement activities and penalties in order to enforce tax compliance. Research in the US (Schwartz and Orleans, 1967) and in Sweden (Vogel, 1974) found that taxpayer norms are important in analysing individual behaviour towards tax obligations. Spicer and Lundstedt (1976) found that the internalised norms and role

moderated such a positive perception, which both contributed indirectly to a less favourable attitude.

This research examined several norms of accounting students at University Utara Malaysia (UUM) to determine what impact these norms may have on the participants' responses to several tax question scenarios such as honesty and sense of moral duty towards the taxation system.

III. OBJECTIVE OF THE STUDY



Out of 560 questionnaires that were distributed at the end of the semester, 551 were returned by the respondents providing a response rate of 98.39%. Five of the questionnaires were rejected due to insufficient data, leaving a total of 546 usable responses.

The Questionnaire

The questionnaire was divided into two parts: Part A and Part B. Part A consisted of four tax case scenarios to measure the behavioural dimension of respondents to tax compliance. After reading each scenario, the respondents were asked to evaluate (on a seven-point “Likert” scale) whether he or she would report their earned income if faced with an identical situation. Part A of the questionnaire comprised of four questions. The first question is structured to gain response to a general public evasion (GE) issue. The second question seeks response to a general public avoidance (GA) issue. The third question relates to a personal evasion (PE) matter and the last question deals with personal avoidance (PA). As mentioned earlier, at the end of the semester, one additional question was added to the same set of questionnaire. The additional question sought from respondents whether their attitude on tax affairs had changed after studying the taxation subject for one semester.

Part B (“demographic information”) solicits respondents’ background information such as gender, age, ethnic group and work background of parents.

Data Analysis

In Part A, a Likert scale was used for most of the questionnaires and the respondents had to tick the appropriate column. In Part B, the questionnaires required a tick for the correct answer. The responses derived from the questionnaires were coded, entered and analysed by using the SPSS statistical package.

V. FINDINGS

This section reports on the respondent’s characteristics, and results of hypotheses introduced for this study.

Respondent’s Characteristics

A summary of the characteristics of respondents is reported in Table 1. For both sets of questionnaire, the percentages of sample characteristics are broadly the same. The sample characteristics suggest that about 26% of the respondents were males and 74% were females. Seventy-one percent of the respondents were Malays, 23% were Chinese, four percent were Indians and two percent were others.

Most of the respondents (84%) are between 20 and 30 years of age. This is because

employed with the Government but most of them (48%) are employed with the private sector.

Hypotheses Testing

The research hypotheses were structured to seek answers to the issues raised in the introduction section, that is, the association, if any, between (i) extent of tax compliance and (ii) level of education. As mentioned earlier, the respondents completed the questionnaires at the commencement as well as at the end of the semester. The survey questionnaires for each of groups were coded in relation to the respondent's background data and the mean scores for each survey question were then determined.

TABLE 1 SUMMARY OF SAMPLE CHARACTERISTICS

	Percent
<u>Gender</u>	
Male	25.7
Female	74.3
	100.0
<u>Ethnic Group</u>	
Malay	70.7
Chinese	23.5
Indian	4.0
Others	1.9
	100.0
<u>Age</u>	
Below 20 years	15.4
20 to 30 years	84.4
Over 30 years	0.2
	100.0
<u>Parent's work background</u>	
Sole proprietor/partnership	15.6
Government servant	23.7
Employed in private sector	47.7
Others	13.0
	100.0
<u>Parent's approximate annual income</u> <u>(Year: 2000)</u>	
Below RM18,000	87.4
RM18,001 to RM36,000	9.9
Above RM36,001	2.7
	100.0

* Number of respondents: 546

The first hypothesis was posited in relation to respondents' scores over time (period of tax education).

H-1: There is no difference in the mean scores of students at the commencement of the semester and at the end of the semester.

Data to test hypothesis, H-1, was gathered from students who completed the Taxation 1 program in May 2001. The student's responses to four taxation scenarios were obtained at the commencement of the semester, and student responses to the same questions were gathered at the end of the semester. No student was identified in relation to his or her response in order to make it confidential and to encourage truthful responses. As such, individual responses could not be compared. Only total responses were analysed. Table 2 summarizes the student mean scores to each of the questions on both occasions.

TABLE 2 COMPARISON OF MEAN SCORES OF TAX QUESTIONS BEFORE AND AFTER TAX EDUCATION

	Commencement of the semester		End of the semester	
	Means	Standard Deviation	Means	Standard Deviation
Q1 GE	4.02	1.45	3.99	1.44
Q2 GA*	4.78	1.34	5.30	1.32
Q3 PE*	4.22	1.31	4.41	1.41
Q4 PA	3.39	1.34	3.41	1.39

* Significant at 5% level

Note: GE: General Evasion GA: General Avoidance PE : Personal Evasion PA : Personal Avoidance

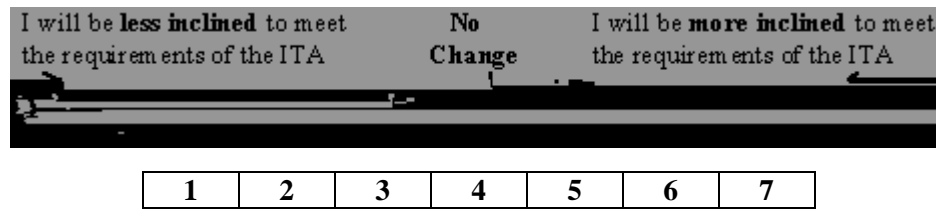
Hypothesis H-1 was partially accepted because the t-test revealed that there was significant difference at five percent level for GA ($t=6.51$, $df=1102$, $p<0.05$) and PE ($t=2.41$, $df=1102$, $p<0.05$). The students seem to be neutral as to whether it is acceptable under the Income Tax Act (ITA) to under-report the income if faced with special circumstances such as unfair tax laws or economic hardship, at the beginning of the semester. After undergoing the tax course, the results showed that student attitudes to the given tax scenarios had changed over time. These findings suggest that students may have become more compliant on tax avoidance and evasion through participation in tax education.

In order to understand whether education can influence students' tax compliance attitude, further tests were carried out in terms of gender and ethnic background. The following hypothesis was formulated, that is:

H-2: There is no difference between the mean scores of males and females in relation to attitude change after one semester of tax education.

Although hypothesis H-1 indirectly tested the influence of one semester of Taxation 1 education on tax compliance attitude of students, hypothesis H-2, was posited as a direct test of students' own view on a possible change in attitude. At the end of the semester (November 2001), the students were asked an additional question which reads as follows:

"My study of tax this semester has influenced my attitude to my own income tax affairs in the following manner."



Student responses were then expressed on a seven point Likert scale with a score of 1 showing a negative change in attitude and a score of 7 displaying a positive change in

TABLE 4: STATISTICALLY DIFFERENT MEAN SCORES AND STANDARD DEVIATION FOR FEMALES ON TAX QUESTIONS

Question Number	Mean		Standard Deviation	
	Commencement of Semester	End of Semester	Commencement of Semester	End of Semester
Q1 GE	4.02	3.99	1.42	1.40
Q2 GA*	4.72	5.25	1.28	1.30
Q3 PE*	4.22	4.44	1.25	1.38
Q4 PA	3.36	3.37	1.25	1.37

* Significant at 5% level

Note: GE: General Evasion GA: General Avoidance PE: Personal Evasion PA: Personal Avoidance

Similar analysis were also undertaken on male attitudes as shown in Table 5. The t-test results revealed that there is a significant difference among male attitudes between the commencement and the end of the semester for only GA ($t=2.91$, $df=270$, $p<0.05$). The findings suggest that male students have shown an improvement in the understanding of the legal provisions pertaining to general tax avoidance under the Act. Indirectly, it has proved that male students' attitudes in respect of general tax avoidance under the Act have changed after undergoing the tax course for one semester.

TABLE 5: MEAN SCORES AND STANDARD DEVIATION FOR MALES ON TAX QUESTIONS

Question Number	Mean		Standard Deviation
	Commencement of Semester	End of Semester	Commencement of Semester

Hypothesis H-3 was accepted. It was observed that in both surveys carried out at the

Furthermore, the findings indicate there is no difference in attitudes between male and females and this is in line with hypothesis 3. The statistical findings of this study confirm the existence of a relationship between education and tax compliance. Therefore, it is suggested that universities offering social science courses as well as

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