

THE INFLUENCE OF TAX FAIRNESS, ETHICAL ATTITUDES AND COMMITMENT ON TAXPAYER COMPLIANCE BEHAVIOR

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ABSTRACT

The aim of this study is to examine the direct and indirect effect of tax fairness, ethical attitudes and commitment on taxpayer compliance behavior. This study was conducted in Surabaya, East Java. The respondents of the study are individual taxpayer working in service industries. Eighty six taxpayers participated in this study. The findings of this study show that: (1) the direct effect tax fairness on taxpayer compliance behavior is positive and significant (2) the indirect effect of tax fairness on taxpayer compliance behavior through ethical attitudes is positive and significant (3) the indirect effect of tax fairness on taxpayer compliance behavior through commitment is positive and significant. This study contribute not only to the research literature but also to help government to develop strategies toward improving compliance.

Keywords: tax fairness, ethical attitudes, commitment, taxpayer compliance behavior.

Introduction

Scholars and policymakers worldwide are interested in how to mitigate tax evasion and maximize compliance with the tax laws. Since individual income taxes are the major source of revenue for a government, non compliance has a significant economic impact. Tackling of the policy problem of tax evasion requires some understanding of the factors underlying the individual's decision to pay or evade his taxes.

In recent years, research interest in the area of taxpayer compliance has grown considerably. Prior researchers have examined how individual compliance is affected by age (Tittle, 1980; Grasmick et al., 1984), Sex (Minor, 1978; Grasmick and Scott, 1980), income source (Madeo et al., 1985), occupation (Mason and Calvin, 1978; Westat, 1980), fairness (Yankelovich et al. 1984; Etzioni, 1986), complexity (Sanders and Wyndelts, 1989; Magro, 1999; Spilker *et al.*, 1999), tax rates (Mason and Calvin, 1984;

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Keller, 1998), tax compliance costs (Nam, 2002), audit adjustments (Chan and Mo, 2002) and moral obligation (Bobek and Hatfield, 2003).

Despite these researches, there has been little research directed to study tax fairness, individual' ethics and commitment in their research for predicting compliance behavior. Fairness is perceived as a basic entitlement, consequently instances of perceived unfairness produce intense personal emotions. When taxpayers perceive unfairness they will react by trying not to pay taxes. Etzioni (1986) argue that if a public feels increasingly over time that taxes are unfairly imposed, it will be increasingly likely to evade paying taxes. Studies in tax fairness and its influence to compliance behavior have been done by Bradley (1994). His findings show that tax evasion increased, as the percentage of taxpayers considering taxes unfair.

Perception of fairness can also create ethical attitudes among taxpayers. this involves moral issues and choices and deals with right and wrong behavior. Ethical attitudes are affected by internal and external forces (Luthans, 2002). It is now realized that not only individuals and groups but also a number of relevant factor from the cultural, organizational and external environment determine ethical behavior. The external forces having an impact on ethical behavior include political, legal, economic, and international developments. Tax fairness leads to better and positive attitude toward tax. It can be said that tax fairness influence taxpayer ethical attitude.

Etzioni (1986) argue that ethical attitudes are an important factors underlying taxpayer behavior and that the variable may be more effective than the other factors in inducing compliance. The importance of ethics is reinforced by a field experimental research undertaken in the united states indicates that ethics play an important role in affecting tax compliance and tax evasion decision (Reckers et al., 1994; Bobek and Hatfield, 2003).

Beside influence ethical attitudes, tax fairness also identified to have an impact on commitment. Perception of fairness can also build commitment among taxpayers. Feeling of fairness could create sense of commitment. Commitment here is defined as the extent to which taxpayers accept the government program and intend to cooperate carrying it out. Koorsgaard et al. (1995) argue that tax fairness allow individual to have a sense of indirect control over the outcome, thereby promoting commitment. The increase commitment among taxpayers will ultimately increase compliance behavior.

The present research is an extension of study done by Bradley (1994), Reckers et al., (1994), Bobek and Hatfield (2003). The important thing that differentiate this study with the others are: (1) The direct effect of tax fairness and ethical attitudes on taxpayer compliance have been examined by previous researchers. This study extended their research by investigating the effect of tax fairness on ethical attitudes, (2) the present study is the first attempt to examine the effect of tax fairness on commitment, and the effect of commitment on compliance behavior.

This research can provide empirical evidence to assist legislators in the development equitable tax system. A significant methodological contribution of this research is the development of a set of scales for measuring tax fairness and ethical attitudes that are believed to have an important effect on compliance behavior. To the author's knowledge, this study is the first attempt to measure these factors using questionnaire, while previous researchers examine the variable using experimental research.

Hypotheses Development

Linkages Between Tax Fairness, Ethical Attitudes and Compliance Behavior

An individual can use different criteria in making ethical choices. One of the criteria is to focus on justice or fairness (Robbins, 2001:144). Fairness is seen as a fundamental human right in social, economic and academic organizations. Since perception is reality to affected individuals, fairness can powerfully influence personal behavior (Henridon, 1992). Fairness is perceived as a basic entitlement, consequently, instances of perceived unfairness could produce intense personal emotions.

Tax fairness encompasses at least two different dimensions (Jackson and Milliron, 1986). One dimension appears to involve the equity of trade – the benefits received for the tax rupiahs given. The other dimension appears to involve the equity of the taxpayer's burden in reference to the other individuals (taxpayers' perceptions of the horizontal and vertical equity of the tax system). In the other words, tax liability among taxpayers should be consistent with the ability to pay. Basically, taxpayers who have the same ability to pay must be imposed the same tax liability, while taxpayers who have different ability to pay must be imposed differently. Besides this, tax fairness also concern with procedural justice that is giving a right to taxpayer to propose an objection, postponement in paying tax and to appeal to tax review body. Perception of fairness can influence taxpayer ethical attitudes because a fair tax will increase ethical values

Etzioni (1988) states that ethical values do not intrude or twist rational deliberations; rather, ethical values render some decision making more effective and efficient. Ethical values affect the decision process by screening or setting bounds on choice possibilities and limiting the means available to achieve desired outcomes. To the extent that ethical values limit choice, they reduce the cognitive effort in information searches, the identification of alternative choices, and the selection among choice (Carroll, 1987). Those alternatives that are not morally acceptable are unlikely to be consciously considered or selected (Reckers et al., 1994). Individual moral belief are important in tax compliance decisions. When tax evasion is seen as a moral issue, individuals are less likely to evade taxes regardless of the tax situation. These arguments lead to the following hypothesis.

H1: There is an indirect effect of tax fairness on compliance behavior through ethical attitudes

Linkage Between Tax Fairness and Taxpayer Compliance

As mentioned above, fairness is based on perception of distributive justice, which is an individual's cognitive evaluation regarding whether or not the amounts of taxes are fair. Fairness also concerned with procedural justice, this is the procedure used to make a decision. Previous researches indicate the taxpayer's perception of the fairness of his tax burden influence taxpayer compliance. In psychological terms, an unfair tax system could lead people to rationalize cheating (Andreoni et al., 1998). Porcano (1984) found that taxpayer need and ability to pay were the most significant variables related to perceptions of a fair tax system. Spicer and Becker (1980) find in an experimental situation that individuals who were told their taxes were higher than others evaded by relatively high amounts, while those who were told their taxes were lower than others evaded by relatively small amounts.

Based on the arguments developed above, tax fairness is expected to have positive and direct effect on compliance behavior.

H2: There is a direct of tax fairness on taxpayer compliance

Linkages Between Tax Fairness, Taxpayer Commitment and Taxpayer Compliance

Luthans (2002:235) define organizational commitment as (!) a willingness to exert high levels of effort on behalf of the organization; (2) a definite belief in, and acceptance of, the values and goals of the organization, and (3) a strong desire to remain a member of a particular organization. Robbins (2001:69) state that organizational commitment is a state in which an employee identifies with a particular organization and its goals, and wishes to maintain membership in the organization. For the present study commitment is defined as taxpayers' acceptance of government goals and their willingness to make it successful.

In organizational context, Meyer and Allen (1991) identified three component of organizational commitment: (1) affective commitment involves the employee's emotional attachment to, identification with, and involvement in the organization, (2) continuance commitment involves commitment based on the costs that the employee associates with leaving organization, (3) normative commitment involves employee's feelings of obligation to stay with the organization because they should; it is the right thing to do. Both early and more recent research summaries do show support of a positive relationship between organizational commitment and desirable outcomes such as job satisfaction, cooperation. Sense of fairness fosters higher sense of commitment to government goals and subsequently enhances compliance behavior.

H3: There is an indirect effect of tax fairness on compliance behavior through commitment

Based on the arguments developed above, the model proposed in the present study is as follows:

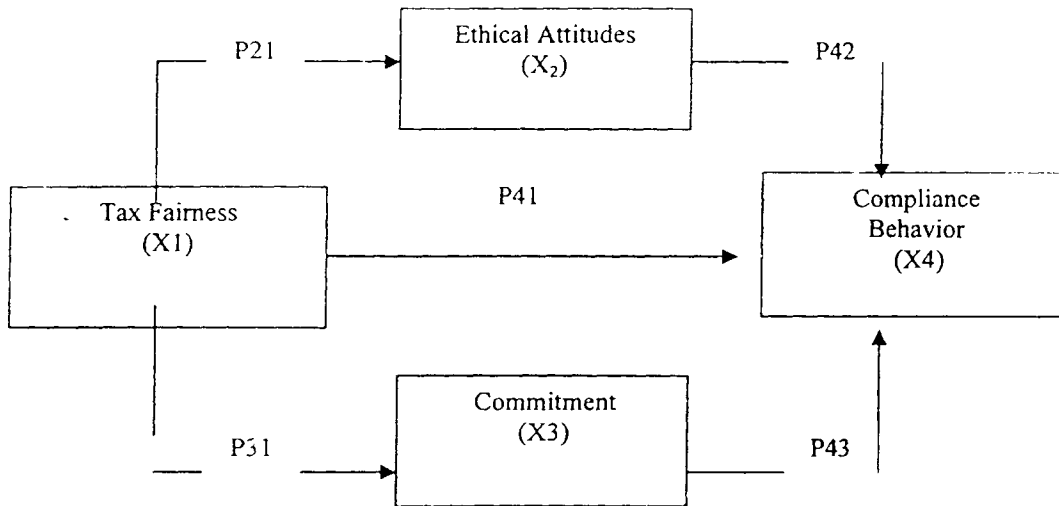


Figure 1
The Model of The Present Study

Research Method

Sample

The population of this study is individual taxpayers working in service industry in Surabaya – East Java. These taxpayers must have worked in the company at least one year, this criteria is important in order to make sure that they understand the tax law which prevails in Indonesia. A total of 100 questionnaires were sent and 91 were returned, making a response rate 91 %. From the total questionnaire received, 5 were excluded from the study for incomplete responses. This left the study with 86 usable questionnaires for data analysis. Tabel 1 below provide demographic data collected from the respondents which encompass gender, age, last formal education and educational background.

Tabel 1
Demographic Data of The Respondents

Variable	Percentage
Age	
• 21 to 30	4
• 31 to 40	34
• Over 40	48
Gender	
• Female	27
• Male	59
Educational background	
• Economics	31
• Engineering	19
• Agriculture	14
• Law	7
• Others	15
Last formal education	
• Senior high school	0
• Undergraduate	19
• Postgraduate	67

Variable Measurement

1. Tax Fairness

Tax fairness is taxpayer' belief that the tax imposed is a fair tax. Four items were developed to measure the tax fairness. This items were based on finding in the tax fairness including factor such as procedural and distributive fairness, equity, equality, an example is "The government (tax employee) treat taxpayers equally in a similar tax situations". A high score on this scale indicates that the tax system is fair while a low score would indicate an unfair tax system.

2. Ethical Attitudes

Ethical attitudes in the present study is to reveal individual perception about tax evasion/noncompliance, whether those attitude is determined as right – wrong, good – bad, or appropriate – inappropriate. Ethical attitudes are measured by 10 items and 5 point likert type. A high score on this scale indicates high ethical attitudes while a low score would indicate low ethical attitudes.

3. Taxpayer Commitment

Commitment is taxpayers' acceptance of government goals and their willingness to make it successful. Perceived commitment is measured by six items and 5 point likert type, modified from Meyer *et al.* (1993) *affective commitment, continuance commitment, normative commitment*. A high score on this scale indicates high commitment while a low score would indicate low commitment.

4. Taxpayer Compliance

Taxpayer compliance is accurate, timely and fully paid return without government enforcement efforts. Five items were developed to measure taxpayer compliance. The items covered in this study consist of the accuracy to fill the tax form, the accuracy in calculating tax liability, timeliness, and voluntary. Taxpayer responded on a 5 point scale ranging from 1 (strongly disagree) to 5 (strongly agree). A high numerical response a perception of high degree of taxpayer compliance.

Analysis Models

A path analytic technique was used to test the model of the study as shown in figure 1. This technique allows examination of the direct and indirect effect (Duncan, 1966; Alwin and hauser, 1975; Lewis – Beck, 1980). In the model, the relationships between variables were specified by a series of path coefficients (P_{ij}) which are equivalent to standardized beta (β). The equation in the path model are shown as follows:

$$X_2 = P_{21}X_1 + P_{2a}R_a \quad (1)$$

$$X_3 = P_{31}X_1 + P_{3b}R_b \quad (2)$$

$$X_4 = P_{41}X_1 + P_{42}X_2 + P_{43}X_3 + P_{4c}R_c \quad (3)$$

The first equation shows the tax fairness (X_1) as the independent variable and ethical attitudes (X_2) as dependent variable. The second equation treated the commitment (X_3) as the dependent variable and tax fairness (X_2) as the independent variable. The third regression equation treated compliance behavior (X_4) as the dependent variable and ethical attitudes (X_2), tax fairness (X_1) and commitment (X_3) as the independent variable.

Based on the three equations above, the direct and indirect are presented in the following Table.

Table 1
Direct and Indirect Effects

Combination of variables	Direct Effects	Indirect Effects	
		Through X_2	Through X_3
X_2 with X_1	P_{21}		
X_3 with X_1	P_{31}		
X_4 with X_1	P_{41}	$P_{42}P_{21}$	$P_{43}P_{31}$
X_4 with X_2	P_{42}		
X_4 with X_3	P_{43}		

Test on the adequacy of the regression models indicate that the assumptions of the models were satisfied by the data. Tests normality indicate that the results of each models are fairly normally distributed. To diagnose multicollinearity, the variance inflation factors (VIFs) are examined for the predictors. VIFs ranged from a low value of 1,000 to a high value of 1.603.

Results

Descriptive Statistics

Table 2 shows the descriptive statistics for the variables used in this study which consists of means, standard deviations, inter – correlations for the four variables measured in the present study.

Tabel 2
Descriptive Statistics and Correlation Matrix of Variables

Variable	Actual (Theoretical) Range	Mean	S.D	1	2	3	4
Tax Fairness	4 - 20 (4 – 20)	10.6279	4.74043	1.000			
Ethical Attitudes	11 – 50 (10 – 50)	25.8721	12.88848	0.489**	1.000		
Commitment	7 - 30 (5 – 30)	17.2674	7.86866	0.466**	0.556**	1.000	
Compliance Behavior	5 – 25 (5 – 25)	14.8488	6.90357	0.594**	0.663**	0.853**	1.000

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

Research Findings

As mentioned above, to test the three hypotheses developed in the present study, three regression equations were employed. The results of the equations are presented in table 3, 4 and 5

Tabel 3
Results of Regression of Equation 1

Regression Results The Effect of Tax Fairness (X_1) on Ethical Attitudes (X_2)				
Variable	Path coefficient	Coefficient value	T value	P
X_1 Tax Fairness	β_1	0.489	5.131	0.000
$R^2 = 0.239$ $F = 26.236$ $n = 86$ $\alpha = 5\%$ ($df = 84$), $t = 1.671$				

Tabel 4
Results of Regression of Equation 2

Regression Results The Effect of Tax Fairness (X_1) on Commitment (X_3)				
Variable	Path coefficient	Coefficient value	T value	P
X_1 Tax Fairness	β_2	0.466	4.827	0.000
$R^2 = 0.217$ $F = 23.304$ $n = 86$ $\alpha = 5\%$ ($df = 84$), $t = 1.671$				

Tabel 5
Results of Regression of Equation 3

Regression Results The Effect of Tax Fairness (X_1), Ethical Attitudes (X_2), Commitment (X_3) on Compliance Behavior (X_4)				
Variable	Path coefficient	Coefficient value	T value	P
X_1 Tax Fairness	β_3	0.190	3.264	0.002
X_2 Ethical Attitudes	β_4	0.211	3.416	0.001
X_3 Commitment	β_5	0.647	10.600	0.000
$R^2 = 0.804$ $F = 112.305$ $n = 86$ $\alpha = 5\%$ ($df = 82$), $t = 1.671$				

Table 6
Path Coefficient of Direct and Indirect Effects

Combination of variables	Direct Effects	Indirect Effects	
		Through X_2	Through X_3
X_2 with X_1	0.489		
X_3 with X_1	0.466		
X_4 with X_1	0.190	0.103	0.302
X_4 with X_2	0.211		
X_4 with X_3	0.647		

Test of Hypothesis 1

Hypothesis 1 states that there is an indirect effect of tax fairness on compliance behavior through ethical attitudes. To test hypothesis 1, the results of regression 1 (table 3) and 3 (table 5) are examined. The results presented in table 3 reveal the presence a positive and significant of direct effect between tax fairness and ethical attitudes [t calculation > t table ($5.131 > 1.671$), $p < 0.05$]. This result provide support for hypothesis

H1. Furthermore, according to the results of the third regression presented in table 5 that there is a positive and significant relationship [t calculation $> t$ table ($3.416 > 1.671$), $p < 0,05$] between ethical attitudes and compliance behavior. These results lead author to conclude that the two path which form indirect effect of tax fairness on compliance behavior through ethical attitudes are significant. The value of the path coefficient of the indirect effect is 0.103 (table 6), therefore H1 could not be rejected.

Test of Hypothesis 2

The second hypothesis of the model requires a test of the expected positive and significant relation between tax fairness and taxpayer compliance. Table 5 presents the results to test hypothesis 2. As shown in table 5, the effect of tax fairness on taxpayer compliance is positive and significant [t calculation $> t$ table ($3.264 > 1.671$), $p < 0,05$]. This means that the results of the path model provide strong support for hypothesis 2.

Test of Hypothesis 3

It is expected in hypothesis 3 that there is indirect effect of tax fairness on compliance behavior through commitment. Table 4 and 5 provide the results to assess the indirect effect. Table 4 reveals that the effect of tax fairness on commitment is positive and significant ($t = 4.827$, $p = 0,000$). Table 5 also provides evidence to support hypotheses 3. Table 5 shows that the effect of tax fairness on compliance behavior is positive and significant ($t = 10.600$, $p = 0,000$). Thus it appears that the primary effect of tax fairness on compliance behavior is via commitment. The value of the path coefficient of the indirect effect is 0.302 (table 6), thereby supporting hypothesis 3.

Discussion, Limitations and Conclusions

The purpose of the present study is to examine empirically the mediating role of ethical attitudes and commitment in the relationship between tax fairness and compliance behavior. The results of this study add our understanding of the factors affecting compliance behavior. The findings of the present study contribute to tax compliance research by providing an explanation of the underlying causes of compliance. This study also provide results that indentify the "root causes" of non compliance to help government to develop strategies toward improving compliance. Thus this study has the potential not only to contribute to the research literature but also assist regulators (government) to make the effective tax law that could increase compliance behavior.

The findings of this study indicate that tax fairness, ethical attitudes and commitment can all influence taxpayers willingness to evade taxes. This results indicate that feeling of unfair tax system increase the propensity to evade. This finding is consistent with the previous researchers that taxpayer need and ability to pay were the most significant variables related to perceptions of a fair tax system. Also, the amount of taxes evaded increase when taxpayers perceived themselves to be victims of fiscal inequity (Andreoni et al., 1998). Furthermore, the results also show that individual moral beliefs and commitment are highly significant in tax compliance decision. This findings

indicate that ethical beliefs are one of the screening factors that taxpayers use in the editing phase of decision making. Thus, taxpayers may edit out of the possibility choices all those that are not viewed as consistent with their moral duty (Bobek and Hatfield, 2003).

Several limitations of this study may be noted. First, this study focus only on three factors that influence compliance behavior. Other factors that influence compliance behavior may exist that were not examined in this study. Second, this study covers only privately owned organizations within service industries. Generalising this results to other industries could be done by further study. Finally, the survey research methodology allows for the examination of statistical associations at one point in time, and the statements about the direction relationships can only be made in terms of consistency of results with the effects proposed in the theoretical discussion. Future research can employ different research methods, for example longitudinal field studies to systematically examine the theoretical causal relationships proposed in this study.

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