

# Voluntary Tax Compliance Behavior in Developing Countries

<sup>1st</sup>Muhammad Shaukat Malik, <sup>2nd</sup>Sabah Younus

*Dean Faculty of Commerce, Law and Business Administration, Director Institute of Banking and Finance, Bahauddin Zakariya University, Multan, Pakistan*

*E-mail: [shoukatmalik@bzu.edu.pk](mailto:shoukatmalik@bzu.edu.pk)*

*PhD Scholar, Institute of Banking and Finance, Bahauddin Zakariya University, Multan, Pakistan*

*Assistant Professor, NUML, Multan*

*E-mail: [sabahfawad@gmail.com](mailto:sabahfawad@gmail.com)*

*Corresponding author: [shoukatmalik@bzu.edu.pk](mailto:shoukatmalik@bzu.edu.pk)*

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**Abstract:** Encouraging voluntary tax-compliance is a major dilemma around the globe that needs immediate solution, this predicament demand even rapid solution in developing countries. As developing countries desire to earn higher revenue through accelerated process of revenue collection by gearing up their tax collection process and adding more and more participants to their tax collection system. Therefore, developing countries are devising mechanism of swift collection of taxes that encourages voluntary compliance. slippery slope framework suggests that power and trust combined together can promote voluntary compliance. this study by using Smart-PLS and utilizing MGA analysis unfold the fact that either developing countries belonging to different income level groups, high income (Indonesia and Iran) and Low-income group (Pakistan), are similar or different in their tax compliance behavior. The findings of this study suggest that individuals belonging to high income groups behave in similar manner, however those belonging to low-income group were significantly different in their behavior. Furthermore, this study recommends that by adopting legitimate power-based policy making process governments can develop a trust-based relationship that urge people to obey government authorities for paying even higher taxes.

**Keywords:** Legitimate Power, Coercive Power, Trust, Voluntary Compliance behavior.

## 1. Introduction

Tax-compliance is a major dilemma for governments of developing countries that requires urgent resolution (Malik & Younus, 2019). Governments around the globe are accelerating their efforts to foster voluntary compliance, as this compliance can result in generating fast-tracking revenues by developing better, transparent and trust-worthy tax collection system (Giriūnienė & Giriūnas, 2015). Tax-collection has been decreased gradually in many countries due to prevailing COVID situation (Megersa, 2020). Governments if desire to have voluntary compliance needs to develop policies that are more transparent, corruptionless, and can develop trust of taxpayers on governments and tax-collection

authorities (Tjondro, 2018). Therefore, building trust of taxpayers is the key target that every government around the globe aims to achieve by investing hard earned money earned by individuals on the welfare of overall society (Freire-González, 2018). If individuals don't trust government, and believe that their money will be looted by government officials and will not be invested for public welfare, they will demonstrate disobedient behavior and will not pay taxes (Forteza & Noboa, 2019).

Trust and power are the two important determinants of tax-compliance behavior (da Silva Freitas, de Santana Ribeiro, de Souza, & Hewings, 2016; Gangl, Hofmann, Hartl, & Berkics, 2019; Prinz & Hokamp, 2015), it has also been observed that people belonging to different culture, ethnic background and countries behave in different manner. As literature lack any comparative analysis that can determine if there exist any difference between countries or not, in their tax-compliance behavior influenced by power and trust. So, this study compares data from three developing countries including Pakistan, Iran, and Indonesia. Indonesia and Iran though are categorised as developing countries, but they are included in emerging middle-income group by World bank according to their revenue generation, whereas Pakistan is included in low-income group under the header of developing countries. Thus, this study's focus on these three developing will give an insight on difference in tax-compliance behavior based on trust on governments by public and power of authorities.

## 2. Literature Review

Voluntary tax-compliance behavior measures the willingness of individuals to pay taxes (da Silva Freitas et al., 2016), voluntary tax compliance emerge in society when people believe that their money paid as taxes to the government will be reinvested for public welfare, their trust on government encourage them to even higher taxes, but when this trust is breached and people believe that government is corrupt or unjust, they will be reluctant to pay tax (da Silva Freitas et al., 2016). Thus, tax-compliance behavior can be highly influenced by trust and use of power (Chong & Arunachalam, 2018). The role of use of power and trust abided relation among government and its citizen was introduced by (Kircher, 2008). Kircher, (2008) introduced the concept of voluntary and enforced tax compliance by introducing theory of Slippery Slope Framework. This framework explains that behavior of taxpayers can be either of two types, willing or hostile (Kastlunger, Lozza, Kirchler, & Schabmann, 2013), if government exercise legitimate power reaction of taxpayers will be willing, however coercive power will create hostile and noncooperative behavior. Based on these studies on available in literature, this research-work's conceptual framework is based on the Slippery Slope Model, that explains the role of coercive power, legitimate power and trust on building voluntary compliance behavior.

Governments when have high trust based relation established with their taxpayers, can rely on using legitimate power for tax collection, whereas if trust is non-existent or weak among people and government, then government is left with no option other than to use coercive power (Siglé, Goslinga, Speklé, Van der, & Veldhuizen, 2018). In most of the developing countries like Pakistan, where governments are struggling to win trust of general public, it is crucial to determine that either power either legitimate or coercive and trust of people on governments play same or different role in determining tax-compliance behavior. Mutual trust-based relation among people of the country and its government is essential to have voluntary compliance towards taxes (Malik & Younus, 2020). This trust is not developed at once, building trust on governments is a gradual process that take time. People upon their observations of investing pattern of government build their perception, if government spending pattern is clear, transparent and accountable (Inasius, 2019), they'll be more compel to pay taxes. Nevertheless, when people perceive that their money is being misused by government official, the trust bond when become weaken as a consequence people start feeling paying taxes as burden on their

pockets and eventually as loss to their business (Bornman & Ramutumbu, 2019). Thus, if mistrust is created in mind of taxpayer, they will not pay taxes in future. Hence it can be hypothesized that,

H1: Trust among individuals and governments has significant relation with Tax-compliance behavior.

Use of power has been characterized as one of the most important contributor of the tax-compliance behavior (Alasfour, 2019; Chong & Arunachalam, 2018; Siglé et al., 2018). Power can be exercised by governments in two forms either legitimate or coercive, both have been studied to consequence into tax-compliance behavior (Kogler et al., 2013). Although, Coercive Power to some extent have been studied to result in voluntary compliance, but with the passage of time people become disobedient and try to avoid taxes (Lisi, 2019). Thus, coercive power can be observed as negative reinforcement which laid foundation of punishment policies by governments to have better compliance ratio (Alasfour, 2019). Whereas, Use of legitimate power enhances the trust on the governments, as legislations is judicious, people develop strong trust on the governments, which then create accelerated tax-revenue for the governments, as people are convinced that their rights and their freedom will not be compromised (Lamberton, 2018). Legitimate power consists of policies for the taxpayers with which they influence behavior through legality of their position (Lisi, 2019). Based on these findings, it can be supposed that,

H2: Use of Power (coercive) by governments has significant relation with Tax-compliance behavior (voluntary).

H3: Use of Power (legitimate) by governments has significant relation with Tax-compliance behavior (voluntary).

### **2.1 Tax compliance in Pakistan, Indonesia, and Iran:**

Pakistan, Indonesia and Iran, thrice of these countries have been nominated as developing countries by World Bank, Indonesia and Iran are included in higher income group (World Bank, 2020), also Pakistan has been list under the countries with low income group, meanwhile Indonesia and Iran belong to high income group. Therefore, through this study it would be evident that either there exist significant difference in their voluntary tax compliance with respect to trust and power, also countries belonging to different income groups are compared. The findings of this study can therefore, become policy guideline for developing countries to accelerate revenue generation process.

Indonesian government is putting its extra efforts to foster voluntary compliance through new policy implication (Porcano, Tsakumis, & Curatola, 2011), the main emphasis of government is to create voluntary compliance atmosphere rather than enforced compliance. Indonesian government in order to increase tax morale is introducing policies that can develop interest of individuals towards paying taxes and eventually towards creating swift tax collection system (Deyneli, 2014). It has also been recommended by researchers to the government of Indonesia to make more transparent tax system to collect more through implementation of judicious tax system, where public money collected as tax is spend on bringing public reforms not on government officials (Abidin, Askandar, & Afifudin, 2018). Similarly, it has been studied that suggested by the researchers to Iran government to be fair and just in reinvesting the public wealth, as it is people's money, collected from people, for the welfare of people (Gahvari & Karimi, 2016). If taxpayers feel that his money is being misused by the government official he will refrain from obedient behavior and will not pay taxes no matter how much force is applied through use of coercive power, that is forcing people to pay taxes by rules of punishment (Gangl et al., 2019). Thus, building a mutual trust-based relation among tax-participants and government must be major goal of every developing country, it has been observed in many developing countries, like Pakistan that governments officials are perceived as corrupt (Saeed, 2020), therefore, people and businesses do not want to pay tax and show low income to avoid paying taxes (Slemrod, Rehman, & Waseem, 2020), which become major reason of lower income of governments. Thus, to resolve this dilemma and to collect maximum revenue as taxes role of use of power and trust had been given

significant importance by the researchers of these three countries. Hence in order to investigate that either there exists significant difference among Pakistan, Indonesia and Iran it can be assumed, H4: There are significant differences in the impact of (i) trust (in authorities), (ii) use of power (Legitimate) (iii) use of power (coercive) on voluntary tax compliance behavior between (i) Indonesia (ii) Iran and (iii) Pakistan.

### 3. Research Methodology

This research study use primary data for analysis, the target population of this research work is owners and business manager of small businesses, as its utmost desire of government of developing countries to encourage these small businesses to become part of their tax system (Bornman & Ramutumbu, 2019). Sample is selected from three developing countries, which include Indonesia, Iran, and Pakistan. From Pakistan data was collected from 179 individuals, from Iran data was collected from 120 individuals and from Indonesia data was collected from 219 individuals. Thus, in this way a final sample of 518 individuals was ready for analysis. Data was collected through online questionnaire. The questionnaire comprises of 22 questions rated using five-point likert scale. The scale of Voluntary tax-compliance was inspired from the study of Kircher, (2008). Other scales of Power and Trust were adopted from the studies of Kastlunger et al., (2013) and Van Dijke & Verboon, (2010). Coercive power, legitimate power and voluntary tax compliance behavior, all three scales comprises of five items, moreover scale of trust had 7 items.

The data collected was processed by using SPSS-23 and Smart PLS 3.3.2. SPSS was used for initial screening of data and demographic analysis, while Smart PLS was used to perform further analysis. Initial screening of data is necessary to determine quality of data collected.

### 4. Analysis and Results

Before conduct of any formal analysis, it is necessary condition to perform missing value analysis, in order to determine if there exist any anomalies in data sets. The next step is to perform sample adequacy test, in order to know either data collected is sufficient to move to further sophisticated analysis or not. KMO value using SPSS was .752 for complete data set, for Indonesia .798 for Iran .803 and for Pakistan .814. which is above the minimum threshold of .7 (Shrestha, 2021). The demographic analysis discovers that out of 518 individuals, 441 were male remaining 77 were female small business owners. out of which 129 males were from Pakistan, 107 males from Iran and 184 were from Indonesia, 35 female respondents belong to Indonesia, only 13 were from Iran, and remaining 50 female respondents were from Pakistan. The demographic analysis also revealed that 78% of the respondents had basic education, that make it easy to comprehend that respondents were able to understand and justifiably were able to answer the question they were asked (Al-Traffi, Bin-Nashwan, & Amrah, 2020).

This study uses structural equation modelling (SEM) approach to investigate model proposed by conceptual framework using Smart PLS 3.3.2, same software is used to analyse group differences among data collected from Pakistan, Indonesia and Iran. Multigroup analysis (MGA) is considered to be the best known techniques to determine group differences (Cheah, Thurasamy, Memon, Chuah, & Ting, 2020). Data analysis is performed in two steps in first step conceptual model developed based on literature review was tested, in second step MGA was performed. The assessment of model is also done in two steps, in first step measurement model was analysed, whereas in second step structural model was examined (Hair, Sarstedt, Hopkins, & Kuppelwieser, 2014). Measurement model testing involves testing of convergent and discriminant validity, whereas structural model testing involves path analysis, also testing of sample explanatory power ( $R^2$ ), sample predictive relevance ( $Q^2$ ) and estimation of standardized root mean square residual (SRMR) (Sarstedt, Ringle, & Hair, 2017). Also, before

conducting MGA prerequisite of MGA was performed that is known as Measurement Invariance of Composite Model (MICOM).

The results of measurement analysis are summarized as Table 1a and 1b. Table 1a presents results of convergent validity analysis, it can be examined from analysis presented in table 1a that Overall data sets bot also data set of individual countries were free from issues of convergent validity. Convergent validity of data is confirmed as all the values of Cronbach alpha are higher than 0.7, also values of average variance extracted (AVE) were higher than minimum threshold of 0.5 (Hair et al., 2014). however, it is important to note that few variables were eliminated based on lower loadings as recommended by Hair et. al., (2014), as removal of these items does not mean that constructs usefulness is compromised. Next in order to access discriminant validity, heterotrait-monotrait (HTMT) ratio of correlations is applied (Henseler, Ringle, & Sarstedt, 2015). The data set is said to before from discriminant validity issues if the value of analysis is less than one it indicates that data is ready to be proceed forward. Table 1b describe the results of discriminant validity.

To proceed forward with analysis structural model was tested, the results of path analysis are briefed in Table 2. The results of the analysis support that H1 is accepted for complete data set and data sets of all three countries is  $B=0.251$  with  $p\text{-value}=0.000$ ,  $B=0.484$  with  $p\text{-value}=0.001$ ,  $B=0.297$  with  $p\text{-value}=0.000$  for Indonesia, Iran, and Pakistan respectively and  $B=0.364$  with  $p\text{-value}=0.000$  for complete data set. Hence it can be inferred that finding of this research work are consistent with findings of Bornman & Ramutumbu, (2019).. Moreover, H2 was accepted with  $B=0.226$  with  $p\text{-value}=0.000$  for complete data set,  $B=0.198$  with  $p\text{-value}=0.000$  for Indonesia data set,  $B=0.345$  with  $p\text{-value}=0.000$  for Pakistan and for Iran with  $B=0.295$  with  $p\text{-value}=0.001$ , these results are consistent with the esteemed research work done by Lamberton, (2018) and Lisi, (2019). The analysis also suggests that for overall data set the Coercive power is significantly negatively related with voluntary tax compliance behavior with  $B=-0.322$  and  $p\text{-value}=0.000$ , whereas for data set of Indonesia it was negatively significant with  $B=-0.332$  with  $p\text{-value}=0.000$ , for Iran data set it was negatively significant with  $B=-0.174$  with  $p\text{-value}=0.000$  and for Pakistan data set  $B=-0.341$  with  $P\text{-value}=0.000$ . thus, it can be inferred that H3 is accepted for complete data set as well as for the data set of three countries, these finding are in accordance with conclusions of Alasfour, (2019) and Lisi, (2019).

*Table 1a: Convergent Validity Analysis*

Samples Variables	Overall Data				Pakistan			Iran			Indonesia		
	$\alpha$	CR	(AVE)	A	CR	(AVE)	A	CR	(AVE)	$\alpha$	CR	(AVE)	
CP	0.719	0.865	0.615	0.789	0.785	0.533	0.821	0.831	0.621	0.754	0.816	0.539	
LP	0.844	0.888	0.614	0.841	0.888	0.623	0.896	0.903	0.642	0.848	0.881	0.526	
TA	0.832	0.877	0.545	0.833	0.861	0.682	0.851	0.873	0.584	0.838	0.857	0.611	
VTCB	0.781	0.851	0.533	0.829	0.85	0.635	0.845	0.869	0.697	0.865	0.888	0.638	

*Table 1b: Discriminant validity analysis*

Discriminant validity: Complete Data set					Discriminant Validity: Indonesia				
	CP	LP	TA	VTCB		CP	LP	TA	VTCB
CP					CP				
LP	0.472				LP	0.433			
TA	0.418	0.376			TA	0.429	0.240		
VTCB	0.541	0.401	0.344		VTCB	0.455	0.501	0.459	
Discriminant validity: Pakistan					Discriminant validity: Iran				
CP					CP				
LP	0.313				LP	0.360			
TA	0.363	0.397			TA	0.212	0.410		
VTCB	0.415	0.519	0.436		VTCB	0.435	0.320	0.430	

*Table 2: Path analysis*

Hypotheses	Complete Data set		Indonesia		Iran		Pakistan	
	$\beta$ (T-statistic)	R <sup>2</sup> /SRMR	$\beta$ (T-statistic)	R <sup>2</sup> /SRMR	$\beta$ (T-statistic)	R <sup>2</sup> /SRMR	$\beta$ (T-statistic)	R <sup>2</sup> /SRMR

	p-value		p-value		p-value		p-value
TA→VTCB	Supported 0.364 (9.774) <b>0.000</b>	38.1%/0.59	Supported 0.484 (10.140) <b>0.000</b>	44.3%/0.61	Supported 0.251 (8.508) <b>0.000</b>	32.1%/0.47	Supported 0.297 (5.359) <b>0.000</b>
LP→VTCB	Supported 0.226 (6.101) <b>0.000</b>		Supported 0.345 (8.367) <b>0.001</b>		Supported 0.295 (3.456) <b>0.001</b>		Supported 0.306 (5.428) <b>0.000</b>
CP→VTCB	Supported -0.332 (9.760) <b>0.000</b>		Supported -0.367 (7.863) <b>0.000</b>		Supported -0.174 (2.215) <b>0.000</b>		Supported -0.341 (6.389) <b>0.000</b>

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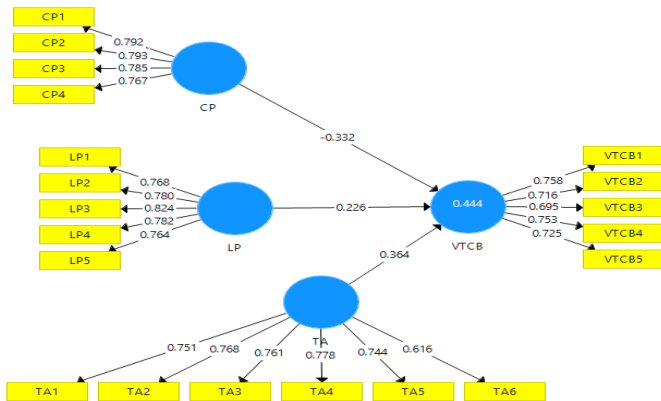


Figure 1: Model Fit Complete data set

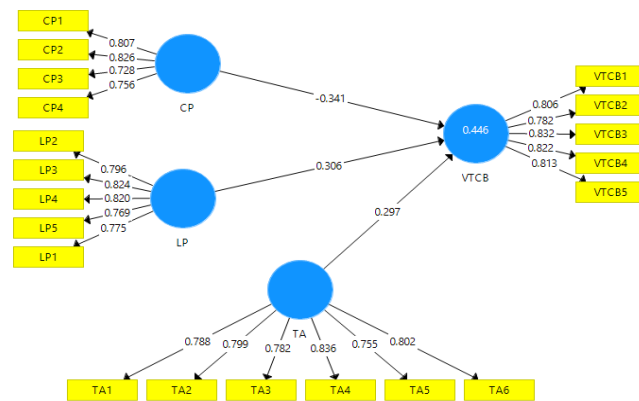


Figure 2: Model Fit Pakistan data set



Figure 3: Model Fit Iran data set



Figure 4: Model Fit Indonesia data set



Analysis also revealed value of R<sup>2</sup> for complete data set is 38.1%, for Indonesia data set 44.3% for Iran data set 32.1% and for Pakistan's data 41.5%. R<sup>2</sup> determines how much variance is explained (Hair et al., 2014). Moreover, value of SRMR for complete data set is 0.063, for Indonesia 0.061, for Iran 0.047 and for Pakistan 0.058. the value of SRMR below 0.80 reflects fitness of model (Henseler, Ringle, & Sarstedt, 2016).

As recommended by Henseler et al., (2016). MICOM analysis was performed. MICOM analysis is a three step process that ensures that data is ready to perform MGA analysis, these three steps are measurement of configural invariance, compositional invariance assessment and equality of composite means values and variances (Henseler et al., 2016). If configural and compositional invariances are proven by the data, it is characterized as partial measurement invariance (Henseler, 2017). But when partial measurement invariance is confirmed along with composite equal mean values and variance across all groups, it is known as full measurement invariance, in both conditions established data analysis can be further proceeded and MGA can be performed (Henseler et al., 2016). Hence, by applying PLS-algorithm procedure with 5000 re-sample, two-tail test was executed. The results of which are presented in Table 3.

To insure configural invariance it must be assured that all data sets to be compared, must behave in a similar fashion (Sinkovics, Henseler, Ringle, & Sarstedt, 2016), which was assured as through path analysis, as all three data set as well as complete data set provided with a model fit with same number of items. Moreover, compositional invariance is achieved as C-value for all the variables and for all data sets was near to one and above 5% quantile, moreover permutation p-value was insignificant (Sinkovics et al., 2016). The results of equal mean and variance test are also narrated in Table 3. The analysis of which reflects that coercive power and trust in authority's full invariance was confirmed, and for legitimate power and voluntary tax compliance partial invariance was recognized. Therefore, data is now ready to perform MGA analysis. The results of MGA are narrated in Table 4.

Table 4 disclosed that among Pakistan for hypothesis for relation among trust in authority's and voluntary tax compliance behavior is not significantly different as p-value=0.071, also the relation among legitimate power and voluntary tax compliance behavior is insignificant with p-value= 0.127, however, coercive power is significantly different for both countries with p-value =0.035 with coefficient 0.241. the comparison results of Pakistan and Iran describe that both trust and coercive power are insignificant, with p-value 0.156 and 0.371 respectively, only legitimate power is significant with p-value=0.042.

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*Table 3: Step 1 and 2 MICOM Analysis*

	Composite invariance				Mean and Variance equality estimates						
	C-value=1	5% quantile	Permutation p-value	Composition al Invariance	Variance differences	95% Confidence Interval	Equal Variance	Mean differences	95% Confidence Interval	Equal Mean	Results
TA	0.989	0.997	0.302	Yes	0.112	-0.174-0.173	Yes	0.158	-0.172-0.178	Yes	Full invariance
CP	1.000	0.998	0.435	Yes	0.039	-0.18-0.19	Yes	0.102	-0.189-0.152	Yes	Full invariance
LP	0.998	0.997	0.113	Yes	0.271	-0.237-0.246	No	-0.081	-0.173-0.183	Yes	Partial invariance
VTCB	0.997	0.999	0.106	Yes	0.138	-0.216-0.180	Yes	-0.277	-0.179-0.190	No	Partial invariance

*Table 4: MGA Analysis*

Groups Hypotheses	Path diff (Pakistan-Indonesia)	p-value (Pakistan-Indonesia)	Path diff (Pakistan-Iran)	p-value (Pakistan-Iran)	Path diff (Indonesia-Iran)	p-value (Indonesia-Iran)
TA→VTCB	-0.187	0.071	0.213	0.156	-0.011	0.860
CP→VTCB	0.241	0.035	-0.285	0.042	0.045	0.522
LP→VTCB	0.194	0.127	0.153	0.371	0.094	0.287

Moreover, comparative analysis of Indonesia and Iran narrates that coercive power, legitimate power, trust, and voluntary tax-compliance behaviour are not significantly different among both countries with p-value 0.860, 0.522 and 0.287 respectively.

## 5. Discussion and conclusion

Based on above analysis it can be observed that power used by authorities and trust of citizen in their government are exceedingly important variables that serve as determinants to develop voluntary tax-compliance of general public. Use of legitimate or coercive power both can result in voluntary compliance (Kogler et al., 2013), but compliance spawned by use of legitimate power fair polices, transparent system of tax collection and spending of tax money collected on individuals welfare can help governments to win trust of their citizen. And hence governments can gear up tax collection process. Moreover, this fact is also of prime importance that voluntary compliance created through force or coercive power is not long-lasting, whereas voluntary compliance that stem out of legitimate more is more enduring and revenue multiplier. Analysis of Pakistan data reflects that people are more inclined to pay taxes when legitimate power is used, same was the case with Indonesia and Iran, however in case of coercive power there was no significant difference among Indonesia and Iran, but both countries were significantly different in relation of coercive power to voluntary tax-compliance. Indonesia and Iran both belong to high income generating group of developing countries, while Pakistan belong to low-income group, therefore it can be assumed that individuals from Indonesia and Iran demonstrate no significant difference, meanwhile Pakistani individuals behave differently when it comes to impact of coercive power on voluntary tax compliance behavior.

## 6. Academic and Policy Implication

This research work is an important contribution towards compliance behavior literature, as this study compares primary data from three different developing countries in order to determine factors that can have impact on voluntary behavior. Moreover, this study can help the governments of the developing countries more specifically that belong to low-income group in making policies that can improve their revenue collection processes. This study supports the literary theory of slippery slope framework and suggest that use of coercive power cannot guarantee long-run revenues for the governments of the developing countries.

## 7. Limitation and Future Recommendations

Like every research work this research work has its own limitations, this study utilizes data collected from three developing countries. To have more generalizable view of the fact data can be collected and compared from other developing countries. A cross comparative analysis can also be performed among developed and developing countries.

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