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The Relationship of Trust in Authority, Procedural Fairness, and Tax Policy Reform on Voluntary Compliance during the Covid-19 Pandemic in Malaysia

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Abstract

The COVID-19 pandemic which occurred in early 2020 is the most concerning topic around the world. Without a doubt, Covid-19 has badly given implications for social, economic, and political aspects of most nations which also impacted global human lives. In Malaysia, it is proven that Covid-19 has mainly caused business activities due to the travel restrictions and border closures such as Movement Control Order (MCO) which is also implemented around the globe. This significant impact on the economy eventually included the tax sector. Tax as the main source of government revenue is crucial to fund crisis response and recovery, in addition to balancing the government's effort in rebuilding Malaysia's fiscal resilience while maintaining its social responsibilities. The condition of taxpayers during this pandemic period also affects the fulfillment of their tax obligation and will give an impact on the country's revenue. This article is an early study to examine the effect of trust in authority, procedural fairness, and tax policy reform on the voluntary compliance response to Covid-19 in Malaysia. Understanding the level of trust in authority, procedural fairness, and tax policy reform is essential to improve tax voluntary compliance. Hence, helps to understand that voluntary compliance facilitates enhancing a viable source of funding for the government.

Keywords: Covid-19 Pandemic, Tax Voluntary Compliance, Trust in Authority, Procedural Fairness, Tax Policy Reform.

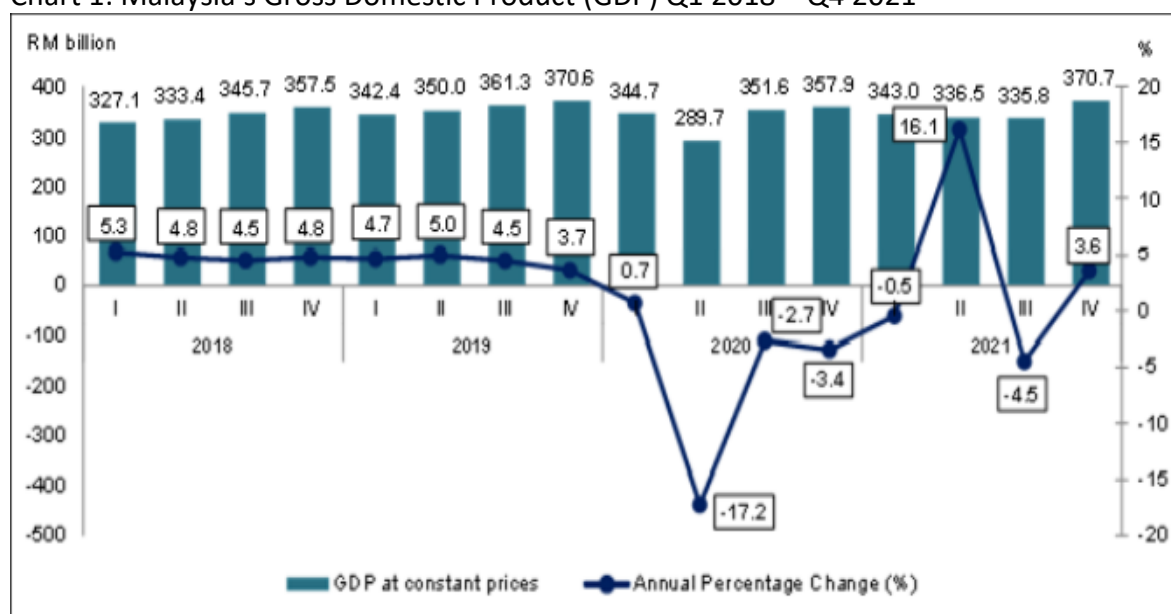
Introduction

In the year 2020, the economic world depression reappear since the last great depression occurred between 1909 to 1939. This was the effect of strong risk aversion and economic disruptions caused by containment measures implemented in response to Coronavirus Disease 2019 (COVID-19). Covid-19 is a newly discovered virus that will cause respiratory infections in humans. It initially began in Wuhan, China and the spread of the infection has halted the economy of the world (Tahajuddin, 2021). Covid-19 has a global impact and puts tremendous pressure on world conditions mainly in the economic and health sectors. As a result, labor market conditions worsened amid a decline in firm production activities, putting pressure on countries' domestic demand, external trade, and global economy, leading to

lower household income and lower purchasing power or consumption. In Malaysia itself, all sectors of the economy are predicted to experience a decline. The travel restrictions (Movement Control Order –MCO) and border closures which were implemented in March 2020, and again in December 2020 until January 2021 in Malaysia, and also among most countries around the world, have remarkable impacts on the society's wellbeing in Malaysia particularly job unemployment (Razak, 2020). The tremendous impact of Covid-19 on human resources in Malaysia also can be shown through the drastic increase in the unemployment rate a few months after the first day of Covid-19 impacted Malaysia. Restrictions imposed throughout the year to prevent the pandemic's spread had a severe impact on labor market conditions in 2020. Employment increased contracted by 0.2 percent (2019: 2.1 percent), resulting in a net loss of 30,000 people, while the unemployment rate rose to 4.5 percent of the labor force, the highest in 30 years (2019: 3.3%).

The Malaysian economy fell by 5.6 percent in 2020, the lowest since 1998, despite a severely challenging global and domestic operating environment (-7.4 percent). This was due to significant weakness in exports, production, and domestic demand as a result of negative external spillovers and the implementation of strict domestic containment measures to battle COVID-19 (Bank Negara, 2021). In 2021, the GDP performance was driven by the recovery sectors such as manufacturing, services and mining, and quarrying sectors, however, it is still below its pre-pandemic level of 2019. According to the current scenario, despite experiencing the Covid-19 pandemic and natural disasters simultaneously, the economic performance of 2021 indicated a rebound. Towards the end of 2021, more economic, social, and recreational activities resumed their operations as all states have turned to Phase 4 of the National Recovery Plan (NRP). The loosening of inter-state travel prohibitions has had significant implications, particularly for domestic tourism sectors. This positive development will allow entrepreneurs to re-energize their businesses, resulting in a recovery in Malaysia's economy.

Chart 1: Malaysia's Gross Domestic Product (GDP) Q1 2018 – Q4 2021



Source: Department of Statistics Malaysia

The tremendous impact of Covid-19 on human resources in Malaysia also can be shown through the drastic increase in the unemployment rate a few months after the first day of Covid-19 impacted Malaysia. Restrictions imposed throughout the year to prevent the pandemic's spread had a severe impact on labor market conditions in 2020. Employment increased contracted by 0.2 percent (2019: 2.1 percent), resulting in a net loss of 30,000 people, while the unemployment rate rose to 4.5 percent of the labor force, the highest in 30 years (2019: 3.3%). From a sectoral context, the construction and tourism-related services industries, which were particularly hard affected by the COVID-19 pandemic, led to a decline in employment growth. Construction employment fell by 4.4% as a result of the postponed implementation of several projects, while employment in the food, beverages, and accommodation subsector fell by 0.4%. In the meantime, retrenchments increased to 104,432 people per year (2019: 29,605 persons) (Department of Statistic, 2022).

Table 1

Labour Force Malaysia (2016 – 2020p)

Selected Labour Market Indicators					
	2016	2017	2018	2019	2020p
Employment ('000 persons)	14,180	14,459	14,810	15,126	15,096
Annual change (%)	1.3	2.0	2.4	2.1	-0.2
Unemployment rate (% of labour force)	3.4	3.4	3.3	3.3	4.5
Labour force participation rate (% of working age population)	67.7	68	68.3	68.7	68.5
Retrenchments (persons)	37,699	35,097	23,168	29,605	104,432
Non-Malaysian citizens employment ('000 persons)	2,205	2,244	2,183	2,237	2,310

p Preliminary

Note: Annual employment growth figures were sourced from the Labour Productivity Statistics publication

Source: Department of Statistics, Malaysia and Ministry of Human Resources

Problem Statement

To respond to the Covid-19 issue, the government table the 2022 budget based on three pillars namely Rakyat's Well Being, Resilient Business, and Prosperous and Sustainable Economy. Malaysia's economy was predicted on the path to recovery and many economic sectors have gradually reopened. As consequence, Malaysia's GDP growth in 2022 is expected to expand between 5.5% to 6.5% (2021:3% to 4%). Whilst the fiscal deficit is projected at 6% of GDP (2021: 6.5%) (Ministry of Finance,2021). The 2022 budget which is the greatest allocation thus far of RM332.1 billion has been allocated to Operating Expenditure (70%), Development Expenditure (23%), and the COVID-19 Fund (7%). Despite Borrowings and the use of Government Assets accounting for around 29.5% of the proposed budget and forecast tax revenue collections of only RM171.4 billion, there are concerns about the country's financial health.

According to the Ministry of Finance, the government revenue collection for the year 2022 is expected to come from Income-tax (35.7%), Borrowing and use of government assets

(29.5%), Non-tax revenue(18.9%), Indirect Tax (13.3%) and Other direct tax (2.6%). Tax is one of the main sources and also the backbone of the state budget. In general, taxes can be interpreted as levies made by the government based on regulations, which are purposely used to finance government expenditure with the aim to facilitate the people (Palupi & Putri, 2021). Therefore, the role of tax administration is the most important to ease the burden of taxpayers during this challenging situation. In this situation, the tax administration may consider how to establish voluntary compliance among taxpayers by measuring the importance of trust in authority, procedural fairness, and tax policy reform, as the voluntary compliance determinants.

Research Questions

Based on relevant issues, the research question of voluntary tax compliance during the Covid-19 Pandemic study was arisen to be answered such as below:

- 1) Does the trust in authority factor contribute to voluntary tax compliance?
- 2) Does the procedural fairness factor contribute to voluntary tax compliance?
- 3) Does the tax policy reform factor contribute to voluntary tax compliance?

Research Objectives

To accomplish the above research questions, the specific research objectives of this study were as follows:

- 1) To examine the relationship between the trust in authority factor and voluntary tax compliance.
- 2) To examine the relationship between procedural fairness factors and voluntary tax compliance.
- 3) To examine the relationship between tax policy reform factors and voluntary tax compliance.

Literature Review

Tax Voluntary Compliance

Tax compliance can be defined based on three dimensions namely filing, reporting, and payment (OECD, 2001). Filing compliance refers to the exact time to file the tax return form while reporting compliance relates to accurate reporting on income and tax liability. Payment compliance means the taxpayer paid all the tax liability on time. In conclusion, tax compliance can be regarded as the degree to which taxpayers comply with the tax regulations (James & Alley, 2009). James and Alley (2009) also emphasize that compliance refers to voluntary behavior. Hence, the further definition of tax compliance is a degree of compliance in terms of law and administration without the implementation of enforcement action taken.

Tax compliance is particularly important to governments around the world as tax is one of the major sources of government revenues. Therefore, in order to ensure that government can finance the various economic activities as well as development projects, tax compliance is a significantly important matter. During this pandemic situation, there is a need to lay a strategic foundation for increasing tax compliance. This is important as the government must increase tax revenue to meet a drastic increase in government spending on health, and social protection and rebuild economic sectors.

To increase tax compliance in pandemic crises, tax authorities should use more carrots instead of sticks to induce tax compliance among taxpayers. In previous studies, coercive models of enforcing compliance through penalties, fines, and tax audits are less effective in

taxpayer compliance (Devos, 2014; Kirchler et al., 2008; Mangoting et al., 2021). In Malaysia, in recent years before the pandemic, there has been a significant increase in the level of audit and investigations activities by tax authorities. However, when the transition of political power occurred, audit and investigation activities slowed, and the Covid crisis emerged. There are some views from the business community and tax consultants to propose the emphasis on tax enforcement to improve tax voluntary compliance.

Educating the taxpayers about their compliance obligations and changing their behavior of the taxpayers to become voluntary compliant is the most preferred action to be done by the tax authority (Thaneermalai, 2021). The focus of audit activity should be an emphasis on educating taxpayers and becoming a partner in helping taxpayers file their tax returns accurately rather than searching for gaps and differences in interpretational to raise additional tax. Van Dijke et al (2019) explain that tax authorities can stimulate a higher voluntary tax compliance level. The built trust in authority will create a positive and mutually beneficial interaction between taxpayers and the government to reduce tax non-compliance (Kirchler et al., 2008). According to Murphy (2003), procedural fairness give positive impacts such as creating commitment, loyalty, and trust among taxpayers which can lead to high compliance. Moreover, the role of the tax authority in reforming the tax administration system to ease the burden on taxpayers and facilitate will encourage taxpayers to voluntarily comply even in this crucial situation (Bedianashvili & Maglakelidze, 2021).

Trust in Authority

Trust is a set of shared beliefs that create a common expectation of honest behavior (Bjørnskov, 2007), as well as a unique relationship between interacting partners who are motivated to keep the relationship continuing by drawing on each other's good qualities (Chong & Arunachalam, 2018). In terms of tax compliance, taxpayers' belief in the government and tax administrator is referred to as trust. Voluntary compliance is enabled by the trust and cooperation that exists between the tax authority and the taxpayer, as well as the taxpayer's willingness to follow the tax authority's rules and regulations on his own.

In Malaysia, tax administration is the responsibility of the Inland Revenue Board of Malaysia (IRBM), which also acts as an agent of the government to deliver tax services such as assessing, administrating, collecting, and enforcing the payment of income tax or other related taxes under its jurisdiction (Inland Revenue Board of Malaysia Act, 1967). Additionally, IRBM is also responsible for advising the government on tax matters and liaising with the appropriate Ministries and statutory bodies on related matters despite participating in or outside Malaysia of taxation issues.

This study will adopt the framework of previous studies, which is the Slippery slope framework to examine the direct relationship between trust in authority and tax compliance. The slippery slope framework named the trust as one of the significant factors that shape voluntary compliance which assumes that tax collections can be increased by increasing trust in authorities and the power of authorities (Kirchler et al., 2008). Taxpayers would expect tax authorities to administer the tax process effectively and perceived the trustworthy government in tax distribution for the nation's development, especially when a response to the Covid-19 pandemic.

Taxpayers with the trust that the tax administrator is efficient in terms of processing tax refunds, processing a tax return, tax investigation, and educating taxpayers in tax matters, will, in turn, would likely comply with tax regulations and would not involve in tax evasion or any forms of non-compliance action. Wahl et al (2010) indicate that when trust strategic

taxpayers exploit the loopholes in the tax system will increase when the trust is low. Changes in power from the tax authority also can influence trust. During this Covid-19 period, tax authorities need to take conservative action, involving taxpayers formulating tax regulations or policies. On the other hand, when tax authorities increase their level of audit and investigation activities, this would be a signal that the authorities implemented the 'cops and robbers' approach which portrays the attitude and distrust of the honesty of taxpayers. Monitoring and penalties can be seen as a sign of distrust (Frey, 2003). Hence, to increase trust, power must be reduced.

A regular audit would be viewed as an intentional act and an indication of mistrust, making it justifiable to look for ways to reduce payments and less support for the authorities. To formulate steps to encourage increased tax compliance in response to the Covid-19, tax authorities should not only focus on enforcement but also on services in educating taxpayers. If taxpayers believe that the government and tax authorities are honest and become partners in helping taxpayers in tax matters, it would boost the motivation for the taxpayers to obey voluntarily (Alm, 2019). This motivation factor of compliance is also in line with the study of Albab and Suwardi (2021) which indicates that one factor influencing trust in authority is the transparent allocation of tax funds.

In this pandemic era, tax policy should also prioritize transparency as per taxpayers' demands. The government should be able to provide transparent monitoring and reporting of domestic revenues, aid, and spending after receiving international financial support, debt relief, and generating additional funding (Gaspar, 2020). Pharmaceutical companies must also be held transparency for license arrangements, trial data, and vaccination distribution to the government. This is in line with the research of Yunus et al (2020) that emphasizes vaccine development is funded through taxpayer money and therefore requires recognition in developing a system that allows for reasonable distribution in the public domain. This is critical for building trust since the taxpayers need to know how funding has been allocated proportionally to the recovery of the economy and health system. Increased transparency and accountability, without doubt, can help boost tax compliance and morale (Verhoeven & Prichard, 2019).

Representing the slippery slope framework, the present study has proposed that the behavior of taxpayers would change according to their opinion and belief about the trust in authorities. This study is an attempt to demonstrate the positive relationship between trust in authority and tax compliance during the Covid-19 pandemic. Thus, the proposed hypothesis is:

H1: Trust in authorities should have a significant positive relationship with tax voluntary compliance.

Procedural Fairness

Procedural justice is the components essential for perceived fairness which are neutrality of the procedure, the trustworthiness of the tax authorities, polite, dignified, and respectful treatment (Tyler & Lind, 1992). Individual taxpayers analyze the treatment they receive from tax authorities, the information they receive, the costs of compliance and administration, and the dynamics of revenue allocation. It is suggested that more information about tax law and explanations for changes can improve taxpayers' perceptions of the tax system's fairness (Olson, 2015). In conclusion procedural fairness relates to how individuals should get fair treatment. Positive attitudes and coordinated responses to the

implementation of regulatory provisions, such as law enforcement and work relations, are influenced by procedural fairness.

The relevant grounded theory of fairness is the heuristic fairness theory and slippery slope framework which proposed unique interaction effects of coercive power and legitimate power with procedural fairness on voluntary tax compliance. Taxpayers who believe the tax authority to be procedurally fair are more willing to trust it, which leads to increase compliance (Murphy, 2003). According to the fairness heuristic theory, taxpayers are expected to pay attention to the fairness of tax authority actions in order to determine if the authority can be trusted not to take advantage of them (Verboon & van Dijke, 2007). This process is considered fair if it is consistent, uses accurate information, and is free from personal interests.

A previous study by Wenzel (2002) explains the perspectives on procedural fairness, that emphasizes decision control as a primary indicator for establishing procedural fairness that allows people to express their concerns and opinions during the decision-making process. As a result, there are no personal or group interests in the implementation of procedural fairness in decision-making. Procedural fairness is important in the context of taxation because it influences how taxpayers interpret it.

Hartner et al (2008) in their study describe procedural fairness can affect tax compliance if tax authorities can treat taxpayers fairly and respectfully based on procedures. As a result, taxpayers will pay the full amount of the tax that is due. This implementation by the authority will give a positive result in maintaining compliance rather than giving a firm action to the taxpayers during the pandemic situation. The government and tax authorities prefer to show empathy through fiscal stimulus initiatives such as extending tax reporting and providing tax reduction and exemption options (Murphy, 2003).

Based on the justification, the hypothesis is proposed as follows:

H2 : Procedural fairness should have a significant positive relationship with tax voluntary compliance.

Tax Administration Reform

Tax reform is motivated by the transition that can bring simplicity to the tax system especially to make the tax system easy to understand and comply with. It is also will cause fairness in the distribution of tax burden and can increase efficiency. By changing tax policy and structure, and improving tax administration, tax reforms frequently aim to achieve a high degree of voluntary compliance, high confidence in the tax administration, and high productivity of the tax authorities (Alm, 2019). One of the elements of tax reform is tax administration reform which also has a role in formulating tax strategy and policy. Tax administration is the way governments operate a tax system, as stated in tax laws, in terms of the actual levying of taxes in order to determine the success of tax collection. Moreover, effective tax administration would boost the support of the government, while the ineffective and arbitrary approach of tax laws can lead to a negative effect on the support and trust of the government (Rahman, 2017).

Covid-19 has impacted people's lives all over the world, which is why most governments are implementing multifaceted and multi-point regulations to protect citizens, facilitate and support businesses, and offer essential services. The tax policy was evaluated to stabilize the national economy, especially on how tax policy will support the government in responding to the Covid-19 crisis (Utami & Ilyas, 2021). The aim of tax administration reform

efforts is mainly to ease tax payments, increase tax compliance, maintain national economic stability, and as a form of government concern for the citizen (Supriyanti & Hapsari, 2021).

In the event of a pandemic, efficient operation of the tax system is crucial to the economy's and business sector's survival to maintain voluntary compliance. Over the previous year since the pandemic wave, several research findings on these issues have been published (OECD, 2020; Gaspar, 2020; Suzuki, 2020; Bedianashvili & Maglakelidze, 2021). The tax administration over the world has taken several measures to address the issues worsened by the pandemic. These measures were taken including giving extra time to settle tax issues such as the extension of the submission form and payment deadline and other tax concessions. Additionally, quicker tax refunds for taxpayers, temporary changes in auditing policies, fast ways to ensure tax sustainability, and improved tax service and communication initiatives are also measures taken by the tax administration.

In Malaysia, the actions taken by the tax administration and the government to help taxpayers since the beginning of the pandemic include tax concessions such as the extension of some tax incentives and tax exemption. Income tax exemption on an aggregate income equivalent to 50% of the amount made in equity crowdfunding was given to the individual investors and the extension of the period of tax incentive for the export of private healthcare services was implemented. There are also tax incentives for the company manufacturing pharmaceutical products including vaccines especially the Covid-19 vaccine was given the income tax rate of 0% up to 10% for the first year, and 10% for the subsequence period of 10 years (KPMG, 2021).

In terms of individual tax, to increase the disposable income of the middle-income group, the tax government agrees to reduce the tax rate for a resident individual from 14% to 13% for a chargeable income band of RM50,001 to RM70,000. Considering the current situation of health climate, income tax relief on expenditure for medical treatment, special needs, and parental care was increased from RM5,000 to RM 8,000. The scope of relief for medical expenses is expanded including vaccination expenses up to RM1,000 for the taxpayer, spouse, and child (KPMG, 2021).

The tax incentive and tax relief as mentioned is a tax policy given by the government to certain taxpayers, either individual or corporate, to provide encouragement and ease of tax reporting which aims to ensure the taxpayers' compliance. This was supported by the study of Amah et al (2021) that analyzed the effect of tax morale, sanction, and tax relaxation which is also known as tax incentives on taxpayer compliance during the pandemic. The tax policy reform factors were supported by the Slippery Slope Framework which emphasizes mutual trust and exchange achievements. Tax authorities legally oblige taxpayers to carry out their obligation and have trust in the government to protect their rights and create an obligation to reciprocate the government's treatment.

A literature review of tax compliance during the pandemic has been conducted by Palupi and Putri (2021) and several studies have shown that the tax policy reform namely tax incentives and tax administration have given a positive impact on tax compliance. These current studies were in line with the studies conducted by Mas'Ud et al (2019) which mention that the trust factor in tax policy reform is an important indicator because it involves taxpayer morale that encourages and motivate taxpayer to comply. From the related discussion, the hypothesis is posited as below:

H3: Tax policy reform should have a significant positive relationship with tax voluntary compliance.

Conceptual Model

Based on the hypotheses development in the previous subsection, the research model is then shown in Figure 1. The model proposes that compliance during a Covid-19 pandemic is influenced by trust in authority, procedural fairness, and tax policy reform. The framework also suggests that the independent variables are expected to have a positive influence on the dependent variable of this paper. This means that the greater the trust in authority, procedural fairness, and tax policy reform, the higher the compliance among taxpayers during the Covid-19 pandemic.

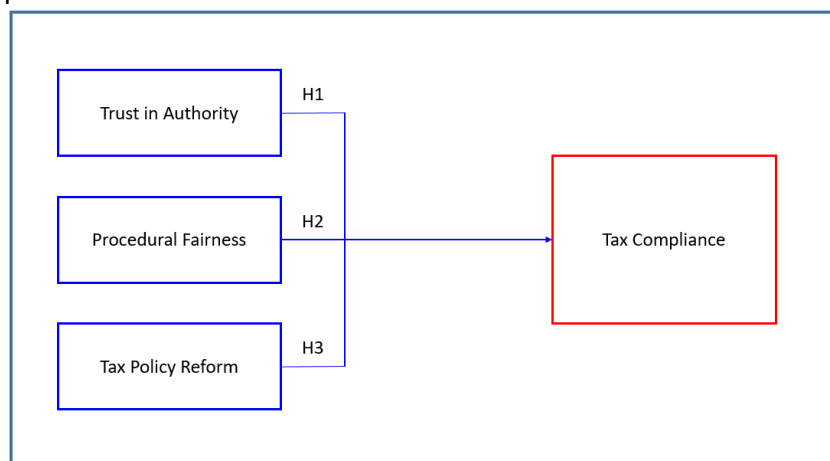


Figure 1. Research Model of Tax Compliance factors

Conclusions and Future Research

The purpose of this paper is to propose a research model of factors influencing taxpayers' compliance in taxation. A review of the relevant past and recent studies indicated that trust in authorities, procedural fairness, and tax policy reform contribute to tax compliance, especially in a midst of a pandemic. In another opinion, a solution to keep maintaining tax compliance in the Covid-19 pandemic is tax policy reform. Tax policy reform including tax incentives, tax relief, and tax administration such as tax services is expected to foster voluntary compliance. During the pandemic, the cash flow of business conditions has become crucial compared to obedience to tax obligations. The extension of the intensives period through the consent of the Ministry of Finance is effectively to overcome tax non-compliance. This paper is a conceptual discussion and limited to the literature review method, without a questionnaires survey and complete interviews with the respondents. Therefore, no empirical evidence is provided. Further research could validate to use of other research methods such as interviews, questionnaires, and group discussions that will get two-way communication with the respondents and get reliable answers from the subject.

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