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Factors Affecting the Tax Compliance among Small and Medium Enterprises' Business Owners in Malaysia

Nazirah Aziz [1], Syed Mahadzir Fadaak Syed Jamil Fadaak [1], Nor Azrina Mohd Yusof [1], Santi Novita [2]

Universiti Teknologi MARA, Faculty of Accountancy, Malaysia [1]
[2] Airlangga University, Accounting department, Indonesia

nazirahaziz@uitm.edu.my ; smfadaak@gmail.com ; yina1437@uitm.edu.my ; santi.novita@feb.unair.ac.id
Tel: 03-32587498

Abstract
This study explores the factors influencing the tax compliance among Small and Medium Enterprises (SMEs) business owners in Malaysia. This study investigates the effect of tax morale, tax complexity, and tax knowledge on tax compliance. This study employed an online survey to collect the data, and 110 SME business owners responded. The regression analysis was used to analyze the data. The findings of this study indicate that tax morale and tax knowledge have a significant impact on tax compliance. The findings of this study could assist IRBM in improving tax compliance among Malaysians, particularly those who manage SMEs.

Keywords: Tax compliance; Small Medium Enterprises.

1.0 Introduction

The tax system in Malaysia has undergone notable revisions to maintain global competitiveness and reduce tax leakages (Sanusi, Abdullah, Chin, Rastam, & Rozzani, 2021). But in most countries, taxation is well known for its flaws. Suppose the taxation system cannot perform appropriately according to its policies to collect tax. In that case, many parties will make use of the benefits to avoid paying tax, thus increasing the tax evasion rate among the citizens. In addition, it also recorded the low percentage of the taxpayer in Malaysia paying taxes. It means that many people fail to comply with taxes (Ghani, Hamid, Sanusi, & Shamsuddin, 2020); Abd Hamid, Harun, Ahmad, Yahya, 2017).

Furthermore, not only individual taxpayers, the level of business taxpayer tax avoidance is still on the rise (IRBM, 2016). Since SMEs make up most businesses in Malaysia, they need to be aware of their tax obligations early on. These SMEs are not registered with the Securities Commission Malaysia or the IRBM. Many people are now interested in this non-compliance issue (Sanusi et al., 2021). There is also a framework called the LHDN Framework: Tackling Issues of Shadow Economy (2019), which says that most SME owners who do not have a license work in an informal sector, also called the "shadow economy." Businesses that don't report their income is called the "shadow economy" (Nchor, 2021). A framework called LHDN Framework: Tackling Issues of the Shadow Economy (2019) covers all types of tax evasion, from casual moonlighting and cash jobs to organized crime. One example is a business that has not been registered with any government agency. This includes all economic activities the government does not know about for money and regulation reasons (Nchor, 2021). However, many of it comes from well-known companies that do not report their earnings (Putni & Sauka, 2015). There are

consequences for everyone in the shadow economy. As registered businesses compete with those in the shadow economy, they are not covered by laws like the minimum wage or the working time directive. These laws do not protect people who work in the shadow economy. Thus, the intention to comply with the tax obligation or the company's taxpayer morale, the complexity of the tax systems, and the taxpayer's knowledge are the main issues predicted to affect the tax compliance.

1.1 Problem statement
An increase in the number of small and medium-sized enterprises (SMEs) in Malaysia has a positive impact on the economy and growth of the country since more tax revenue is collected from SME business owners. While this may be accurate in the case of authority, the nature of SME businesses that operate without being registered with the tax office may make it more challenging to assess taxes on them. Tax avoidance and tax evasion arise when an individual or SME deliberately fails their tax responsibility. Tax avoidance is defined as using tax rules in ways the government did not intend. It is a method of avoiding or reducing the amount of tax owed. Tax avoidance has broad and narrow definitions in accounting literature. Tax avoidance is broadly described as the ability to pay a low tax rate per dollar of reported pretax financial accounting income (Hoseini et al., 2019).

This study will provide an insight into the factors that affect Malaysian SME owners' tax compliance. Tax revenues are critical since they fund all government programs and federal employee pay. The tax revenue is used to pay for all necessary public structures and administrations. Tax revenue is substantial because it may help close budget deficits while supporting economic development and wealth. Tax revenues are vital since they cover the cost of all government services and the salaries of federal servants. The government uses all taxes to fund all necessary public infrastructure and administrations. Tax income is critical because it may assist in eliminating fiscal deficits and boosting economic growth and wealth.

1.2 Research objectives
This study aims to identify factors influencing the tax compliance among SME business owners in Malaysia. Specifically, the objectives of this study are as follows:
RO 1: To study the influence of tax morale on tax compliance among SME business owners in Malaysia.
RO 2: To study the influence of tax complexity on tax compliance among SME business owners in Malaysia.
RO 3: To study the influence of tax knowledge on tax compliance among SME business owners in Malaysia.

1.3 Significance of the study
This study intends to pave the way for IRBM to boost the tax compliance rate among SME business owners in Malaysia, particularly SME-business owners who contribute significantly to the IRBM tax collection revenue. This study also intends to contribute to other parties' knowledge development, practical improvement, and policy information.

2.0 Literature review
This section explains the description of the variables used in this study. It evaluates the past studies in tax compliance, tax morale, tax complexity, and tax knowledge in greater detail. The development of the hypothesis and the research framework will be discussed in greater detail in the second half of this section.

2.1 Tax compliance
Tax compliance is the main factor affecting tax revenue (Wicaksono & Lestari, 2017). There have been a lot of efforts taken to increase the tax compliance rate in many Malaysia, as such are audits and penalties. However, several studies have shown that the tax compliance rate is affected by socio-psychological factors. The relationship of the tax compliance rate is significantly influenced by tax consciousness which has been studied for years (Nurkhin et al., 2018). Knowledge, morale, complexity of a subject, and other aspects are bound coherently to a person's consciousness. Public perception of taxation is that they are not at a disadvantage in tax collection when paying tax and are not obliged to pay tax. Malaysian citizens are not well informed on their benefits when paying taxes. Thus, this leads to the obstacle of tax awareness regarding tax collection from society (Kamil, 2015). In a self-assessment system (SAS), the broader view of compliance becomes critical because the total amount of tax payable depends highly on this view's level of tax compliance. The IRBM also reports that the tax non compliance issue is still on the rise. Hence, low tax compliance indicates that something needs to be done to improve Malaysia's tax system and tax attitude if the country becomes a developed nation in the future.

2.1.2 Tax morale
Individual and corporate tax evasion also resulted in a decrease in government revenue collection. To increase voluntary compliance among all taxpayers, an effective tax awareness focusing on factors such as taxpayer morale, taxpayer knowledge, and the tax system's simplicity must be established (LHDN, 2019). This is because morality and knowledge are defined on numerous levels by human reasoning, points of view, and living conception. At the same time, the system's simplicity encourages taxpayers to pay taxes without fear of coercion, as the system is easily accessible (OECD, 2008). Although these factors typically occur due to a human being's reaction to material circumstances in life, they can also occur during periods of historical change due to an individual's reflection on their thoughts, attitudes, and conceptions (Hamed, 2020).

Thus, applying the concept of awareness to individual taxpayers increases their understanding and positive perception of the necessity of contributing to the burden of public obligations and paying the requirements arising from the services they provide to fulfill

their various responsibilities (Hamed, 2020). Thus, to assist individual taxpayers in carrying out their different duties, the concept of awareness should be applied where it can foster an understanding and positive perception of the importance of contributing to the burden of public obligations and paying the requirements arising from the services they provide (Hamed, 2020).

2.1.3 Tax complexity
In a tax system, tax complexity seems to be a problem, and it is often mentioned as one of the things that might make people not pay their taxes. On the other hand, a simple tax system may make it easier for people to pay their taxes (Isa, 2014). A quote from Anggoro (2018) says that tax laws should be easy for people to understand and follow. In Malaysia, the Self-Assessment System (SAS) was first used by the IRBM for corporations in 2001. It was then used by individual taxpayers, such as sole proprietors, partnerships, cooperatives, and salaried workers, in 2004 to help them pay taxes. Under SAS, taxpayers are supposed to do all the work of figuring out how much tax they owe. This includes everything from documenting the relevant support to figuring out how much tax they owe. Then, tax compliance is essential because taxpayers are responsible for submitting their tax returns on time and in the correct way. However, people may not follow the law because the tax system is complicated or the tax rules are complex.

The level of tax complexity may change the way people act. Using an improper tax deduction to avoid paying taxes may be considered a socially and ethically acceptable way to avoid paying taxes, says Nugent (2013). This is because tax laws can be very complicated. More complicated taxes are linked to people who don't think taking uncertain deductions is moral. People who do not feel taking doubtful beliefs is honest are more likely to take them. Oyewole (2014) and Richardson and Sawyer (2001) found that small-business owners who don't pay their taxes are more likely to do so because of how complicated taxes can be. According to Kirchler et al. (2008), tax knowledge and the simpleness of tax returns affect compliance differently. A taxpayer with little tax knowledge may be able to file accurate tax returns if the tax filings are simple, well-explained, and consistent.

2.1.4 Tax knowledge
Tax knowledge refers to the capacity of a taxpayer to comprehend tax rules and regulations (Ayuba, Saad, & Arifin, 2016). According to Pratama (2018), tax knowledge is a level of comprehension of fundamental tax concepts, including tax law and financial knowledge, that taxpayers must possess to fulfill their tax obligations. Tax knowledge is critical in a voluntary compliance tax system (Jeyapalan, 2003), mainly when calculating an accurate tax liability (Palil, 2005; Saad et al., 2003). Additionally, Osebe (2013) emphasized the importance of education in helping taxpayers understand the tax system and their tax obligations and rights. Previous research by Newman, Charity, and Ongayi (2018), Manual and Xin (2016), and Omagor and Mubiru (2008) established a relationship between tax knowledge and compliance, where an increase in tax knowledge can increase tax compliance. Kasipillai and Jabbar (2003) and Kirchler et al. (2006), also established that acquiring tax knowledge results in increased compliance rates. Similarly, a lack of tax knowledge can result in intentional or unintentional non-compliance on the part of taxpayers.

2.2 Hypotheses development
2.2.1 Tax Morale and Tax Compliance
Tax morale is the intrinsic motivation to pay taxes, arising from the moral obligation to pay taxes and the trust in contributing to society by paying taxes, as defined by Cummings et al. (2006) and similarly explained by Bosco and Mittone (1997). Prior research indicates a significant positive relationship between tax morale and tax compliance. Thus, the present study hypothesized that:

H1: There is a positive relationship between tax morale and tax compliance among SME business owners in Malaysia.

2.2.2 Tax Complexity and Tax Compliance
Tax complexity is one of the vital compliance characteristics of tax auditors among corporate taxpayers (Isa, 2014). Tax complexity is another factor that can affect the level of tax compliance. According to Richardson (2008), tax complexity is among the main factors affecting tax compliance among taxpayers. Prior study indicates a significant positive relationship between tax complexity and tax compliance. Thus, the present study hypothesized that:

H2: There is a positive relationship between tax complexity and tax compliance among SME business owners in Malaysia.

2.2.3 Tax Knowledge and Tax Compliance
Taxpayers' education level significantly impacts their general knowledge of taxation, particularly concerning the rules and regulations that govern it (Eriksen & Fallan, 1996). According to Eriksen and Fallan (1996: 387), knowledge of tax legislation is crucial for choices and attitudes regarding taxation. Prior study indicates a significant positive relationship between tax knowledge and tax compliance. Thus, the present study hypothesized that:

H3: There is a positive relationship between tax knowledge and tax compliance among SME business owners in Malaysia.

2.3 Conceptual framework
The following figure illustrates the conceptual framework of this study. This study examines the influence of tax morale, tax complexity, and tax knowledge on tax compliance.
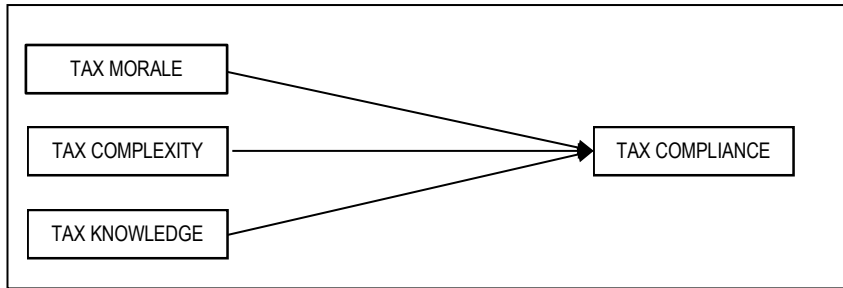
Fig. 1: Conceptual framework

3.0 Methodology
This section describes the sample and procedure, and measurement of variables. This section also provides the measurement of the variables used in the study.

3.1 Sample and procedure
This study employed an online survey to examine the relationships between three independent variables (tax morale, tax complexity, and tax knowledge) and tax compliance among SME business owners in Malaysia. The study population will include all 907,065 SMEs registered under the Commission Companies of Malaysia (Department of Statistics, 2016). Due to the access, location, and time constraints, this study adopted a convenient sampling method—SME business owners who are the clients of MAFM International Sdn. Bhd, located at Klang Valley, were selected as a target sample. Selangor has the highest proportion of SMEs, followed by Kuala Lumpur, which has more than one-third of the total SMEs (Department of Statistics, 2016). A total of 110 responses were obtained from 180 questionnaires distributed to SME business owners at Klang Valley. According to Roscoe's (1975) rule of thumb for determining sample size, 110 respondents are considered acceptable.

The structured survey using a 5 - point Likert scale was employed to gather data for the proposed variables. The survey is divided into three parts: A, B, and C. Part A focus on personal information about the respondent. Part B seeks questions on tax compliance (dependent variable), whereas Part C focuses on three independent dependent variables.

3.2 Measurement of variables
Thirty-eight items were utilised to discover the elements that influence tax compliance behavior. The items on the questionnaire were grouped into four categories: tax morale, tax complexity, tax knowledge, and tax compliance. The tax morale elements will assess the micro-motivation businesses to pay taxes. On the other hand, tax complexity will put respondents to the test regarding their impression of the tax system, and whether it is easy or difficult to assess their tax. The tax compliance will determine the SME owner's comprehension of the Malaysian tax system and their compliance with the Malaysian taxation system. Finally, the tax knowledge will assess taxpayers' understanding of taxes and IRBM monitoring programs. The questionnaire was adapted from works by Alm and Torgler (2006), Kasipillai and Jabbar (2006), Ho et al. (2006), Palil (2016), Ghani (2007), and Ghani et al. (2020). The questions were then reassembled and changed to fit the Malaysian context.

3.3 Research equation

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \tag{1}$$

Where,

Y	=	Tax Compliance	X3	=	Tax Knowledge
X1	=	Tax Morale	ε	=	Random Error
X2	=	Tax Complexity			

4.0 Analysis and results
This section presents the findings of the study. IBM SPSS version 26.0 was used to analyze the existing data using some of the statistical analyses related to the main aim of this study. The analysis consists of descriptive analysis that provides respondents' characteristics from the demographic profile. This section also provides the results of multiple linear regression analysis.

4.1 Demographic profile
Table 1 presents the demographic profile of the respondents who participated in the study. The respondents were grouped into a few categories regarding gender, age, level of education, monthly income, and working experience. The majority of respondents (55.5%) are

female. Regarding age, most respondents (40%) are between the ages of 30 and 39. About 54.5% of respondents hold a bachelor's degree and 7.2% have a Ph.D. and Professional certificate. Compared to others, a higher education level suggests they may have some knowledge or even be aware of tax laws, rules, and regulations. Besides, most respondents have a monthly income of below RM 10,000 (63.6%), followed by RM 10,001–RM 50,000 (23.6%). This somewhat indicates that all these respondents do have experience as individual taxpayers. Moreover, almost 45% of respondents have more than 10 years of working experience, and it is believed that as time passed, they developed their knowledge of tax laws and regulations. With regard to the type of business, the majority of respondents (67.3%) are from the service sector, which is in line with the Department of Statistics (2016) that stated the service sector was the major contributor to the SMEs in Malaysia.

Table 1: Demographic Profile of Respondents

Item	Frequency	Percentage (%)
Gender		
Male	49	44.5
Female	61	55.5
Age (Years old)		
18-29	21	19.1
30- 39	44	40.0
40- 49	13	11.8
50- 59	16	14.5
60 and above	16	14.5
Education Level		
SPM/SPMV	27	24.5
STPM/STAM	1	0.9
Sijil/Diploma	0	0.0
Bachelor's	60	54.5
Master's	14	12.7
Doctor of Philosophy	4	3.6
Professional Certificate	4	3.6
Range of Monthly Individual Income		
Below RM10,000	70	63.6
RM 10,001 - RM 50,000	26	23.6
RM 50,001 – RM 100,000	7	6.4
RM 100,001 – RM 300,000	7	6.4
Business or Working Experience		
less than 3 years	22	20.0
3 – 6 years	1	0.9
6-10 years	38	34.5
More than 10 years	49	44.5
Type of Business		
Retail	9	8.2
Services	74	67.3
Food and beverages	8	7.3
Others	19	17.3

(Source: authors)

4.2 Reliability analysis

Reliability analysis was conducted on the measurement scales of all constructs. The Cronbach's alpha is used to measure reliability or internal consistency. Overall, the values of Cronbach's alpha for all research variables are more than the acceptable and recommended value of 0.7. The result shows that all the 38 selected items are reliable and valid for measuring the variables.

Table 2: Reliability Results of Measuring Instrument

Variables	Items	Cronbach's Alpha
Tax Compliance	8	0.774
Tax Morale	10	0.861
Tax Complexity	10	0.839
Tax Knowledge	10	0.898

(Source: authors)

4.3 Multiple linear regression

The multiple linear regression (MLR) was used to test the contribution of three independent variables (*Tax Morale, Tax Complexity,* and *Tax Knowledge*) in predicting *Tax Compliance*. Table 3 presents the MLR results for tax compliance. At the 5% significant level, the regression model was significant ($F_{(3, 109)} = 20.18$; $p<0.001$) and accounted for 82.6% of the variance in *Tax Compliance. Tax Morale* ($\hat{\beta}= 0.444$, $p<0.001$) was positively significant in the model, thus, H1 is supported. The findings support the results from past studies (Torgler, 2013; Kemme, 2020, Robbins, 2020). Similarly, this study found that *Tax Knowledge* ($\hat{\beta}= 0.273$, $p<0.05$) was positively significant in the model. Thus, H3 also is supported, and the result is in line with past studies (Eriksen & Fallan, 1996; Setyonugroho, 2013). Whereas *Tax Complexity* ($\hat{\beta}= -0.031$, $p>0.05$) is found to be insignificant, resulting in rejecting H2. The finding parallels Abdul and Mcfie (2021), who found that tax complexity does not affect tax compliance.

Table 3: Multiple Regression Result

	Unstandardized Beta	Standardized Beta	*t*-value	*p*-value
(Constant)	5.629		2.132	0.035
Tax Morale	0.361	0.444	4.619	0.000***
Tax Complexity	-0.026	- 0.031	-0.244	0.808
Tax Knowledge	0.200	0.273	2.324	0.022**
F-value	20.18***			
R²	0.826			
Adjusted *R²*	0.682			

Note: * $p < 0.10$, two tailed, **$p < 0.05$, two tailed, ***$p < 0.01$, two tailed.

5.0 Discussion

Tax non-compliance issues, whether intentional or unintentional, appear to have worsened in recent years. The tax authority has been working hard to reduce tax evasion and enhance voluntary compliance (Ghani et al., 2012). The primary purpose of this research is to investigate the factors influencing tax compliance among Malaysian SME owners. Based on the findings of this study, it can be concluded that tax morale and tax knowledge significantly affect SMEs' tax compliance. Results also imply that an improvement in tax morale may lead to an increase in tax compliance. This outcome is consistent with other studies that show that tax morale leads to increased tax compliance (Torgler, 2013; Kemme, 2020). The moral attitude does affect tax compliance (Robbins, 2020). Although prior research was conducted in large corporations, tax morale and tax compliance are comparable among Malaysian SME owners. This result is consistent with the theory of planned behavior (Ajzen, 1991) that if behavioral beliefs form the attitudes. Furthermore, in the SME, one's a moral responsibility to share the liability of having gains and losses of collusive behavior to the partner or team (Lohse and Simon, 2021).

This study also found a positive relationship between tax knowledge and tax compliance. A consequent improvement in a taxpayer's tax knowledge will undoubtedly increase tax compliance on the taxpayer's part (Setyonugroho, 2013). Yet there was no significant relationship between tax complexity and tax compliance among SME business owners in Malaysia. However, according to Isa (2014), a less complicated tax system should have influenced the tax compliance rate among SME business owners in Malaysia. This result is consistent with Abdul and Mcfie (2021) that the tax complexity does not affect compliance. It is due to the role of tax agents in their reporting obligation. This study contributes to the literature by finding that tax knowledge and morale are significant factors in explaining tax compliance behavior. The environment to share the personal value with the partner in SME shows that the theory of planned behavior can be tested.

6.0 Conclusion and Recommendations

Tax non-compliance issues, whether intentional or unintentional, appear to have worsened in recent years. The tax authority has been working hard to reduce tax evasion and enhance voluntary compliance (Ghani et al., 2012). The primary purpose of this research is to investigate the factors influencing tax compliance among Malaysian SME business owners. This study found that tax morale and tax knowledge affect tax compliance, whereas tax complexity was insignificant. The findings have several implications to tax authorities and policymakers. Firstly, tax authorities and policy makers need to reassess their tax laws, rules and regulations by making them less complex. Although this study found insignificant result between tax complexity and tax compliance, the negative relationship suggests that higher complexity will reduce compliance among SME business owners. It is believed that the frequent changes in tax laws will also contribute to low tax compliance. The significant result between tax morale and tax knowledge with tax compliance suggests that taxpayers with some knowledge on tax laws will make them aware of their responsibility as taxpayers. As a result, knowledge of tax laws will motivate taxpayers to become moral person and have some intrinsic motivation to comply with tax laws. Thus, it is suggested that tax authorities and policymakers, such as the Ministry of Higher Education, introduce tax education to all non-accounting undergraduates to have some basic knowledge of the responsibility and their contribution as a taxpayer.

Furthermore, this study may provide insight to academicians into what to look for when assessing tax compliance. Previous research used a range of metrics for evaluating tax compliance and non-compliance. The scope of the measurement was expanded in this study to include SME business owners. This study provides ideas and evidence for further research into tax compliance challenges among Malaysian SME business owners. Low tax compliance indicates that something must be done to improve Malaysia's tax system and tax attitude if the country becomes a developed country. Regarding the limitation, this study employed a convenience sampling method to collect data. This method is a relatively fast and easy way to achieve the sample size needed; nevertheless, care should be exercised when generalizing the findings since the respondents only came from Klang Valley.

Acknowledgements

Paper Contribution to Related Field of Study

This study could assist IRBM in improving tax compliance among Malaysians, particularly those who manage SMEs.

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