

DETERMINANTS OF FACTORS INFLUENCING TAX AVOIDANCE IN PREPARING FINANCIAL STATEMENT AMONG SME TAXPAYERS

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ABSTRACT

The tax avoidance cases in Malaysia increased year by year. The tax avoidance led to country revenue under collected. Therefore, this study aims to investigate the factors that lead to tax avoidance among SME taxpayers in Penang, Malaysia. The study is performed by adopting the Approach-Avoidance Theory model. This model widely used to explain the decision making by the taxpayers to involve in tax avoidance activities. The framework of the study focused on four level factors namely tax complexity, tax compliance costs, tax rate and government transparency spending and tax education and tax knowledge. The objectives of this study are to determine the level and the relationship of tax complexity, tax compliance costs, tax rate and government transparency spending and tax education and tax knowledge and tax avoidance. This study employed the quantitative method by distributing the surveys to the SME taxpayers in Penang state. The total sample of this study was 420 respondents. Collected data were analyzed by using SPSS statistic version 25. As a result, the findings from the regression analysis revealed that tax complexity, tax compliance costs and tax education and tax knowledge significantly on the tax avoidance activities among SME taxpayers in Penang state. However, the study discovered that there is an insignificantly relationship between tax rate and government transparency spending with tax avoidance activities in Penang state. The results of this research are used to develop awareness among the SME owners and to reduce the tax avoidance cases in Penang, Malaysia.

JEL classification: H26.

Keywords: Tax avoidance, tax compliance costs, tax complexity, tax education, tax knowledge, tax rate, government transparency spending.

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1. INTRODUCTION

Tax avoidance has always been an issue for this country as it is considered as legal tax planning activities for the taxpayers to reduce their tax payment (Ariffin, 2013). Tax avoidance cases in Malaysia increased year by year. Tax avoidance causes to the country's revenue under collected (Dalu, 2012). Lembaga Hasil Dalam Negeri (LHDN) has set a higher target for tax collection and more field audits by visiting individuals' taxpayers and companies to collect tax and minimize tax avoidance in Malaysia (LHDN, 2017). Fines and penalties also implement by the government to reduce tax avoidance

and encourage tax compliance among taxpayers because the fines and penalties are effective ways to control tax avoidance and evasion (Mohdali, Isa & Yusoff, 2014). Incorrect tax filing that included underreporting and overreporting the income and evasion of tax may lead to fines and penalty. However, in the Income Tax Act 1967, there are no fines and penalty for tax avoidance because it is legal tax planning to reduce the tax payment. The New Straits Times online news titled “IRB: 80,000 individuals didn’t pay tax” dated 13 Nov 2018 mentioned that a significant number of taxpayers do not comply with the taxation law and are involved in tax avoidance and evasion activities. According to John and Enoch (2013), the tax rate is the factors that cause taxpayers to be unwilling to comply with taxation laws.

Lack of transparency in spending the collected tax by the government also can be one of the factors that cause tax avoidance among the taxpayers. Without good rewards from the government, taxpayers are more liable to be involved in tax avoidance activities (John & Enoch, 2013). Tax education and tax knowledge might also be a factor to determine the tax avoidance among taxpayers. Lack of tax knowledge will lead to lack of awareness of the impact of tax non-compliance among taxpayers (Kolodziej, 2011; Kasipillai, Amran & Aripin, 2003). Tax complexity might also be a determination of tax avoidance. A complicated tax system (Nkwe, 2013; Deyganto, 2018) and e-filing system (Ibrahim, 2016) has led to taxpayers being unable to comply with taxation laws and incurring high compliance costs. Past literature review shows tax compliance costs can affect tax avoidance. Tax compliance costs is a burden to taxpayers when complying with taxation laws (Eragbhe & Modugy, 2014; Eichfelder & Schorn, 2009).

The study by Jabbar (2007) suggests Small Medium Enterprise (SME) involve in tax avoidance because the SME taxpayers need more funds for their business operation so they tend to reduce tax payment. Thus, this study is conducted to find out more about tax avoidance activities among SMEs in Penang Malaysia by using the approach-avoidance theory introduced by Kurt Lewin in 1935. According to the approach-avoidance theory, it discusses the decision making toward tax avoidance activities that have positive and negative effects that affected by environmental psychology by tax rate, tax compliance costs, tax complexity, etc. The objective of this study is to determine the level and relationship tax complexity, tax compliance costs, tax rate and government transparency spending, education and tax knowledge with tax avoidance among SME taxpayers in Penang. This study will contribute to the understanding of factors influencing SME owners involved in the tax avoidance activities in Penang state. The findings of this study are to help Malaysia to increase tax collection and increase the transparency spending of government in the country and social development.

2. LITERATURE REVIEW

Small Medium Enterprise (SME) is a basic business entity type in Malaysia. There is a total of 907,065 SMEs in Malaysia (SME Annual Report, 2018/2019). The definition of SME in Malaysia is measured by their annual sales turnover and the number of full-time staff hired in the organization. SMEs can be divided into two sectors namely the manufacturing sector and services sector and can be divided into three categories, namely micro, small, and medium SME. Tax avoidance is the arrangement of one’s financial affairs to minimize tax liability within the law while tax evasion minimizes tax liability against the law (Arifin, 2013; Putra, Syah & Sriwedari, 2018). According to Kasipillai, Aripin and Amran (2003), tax avoidance is the action taken by taxpayers who manages his affairs in a proper and legal manner in reducing tax payment. Tax avoidance is the

action or decision made by the taxpayer either with their personal knowledge or on the professional advice from their accountant and tax agent to reduce paying tax liability (Putra, Syah & Sriwedari, 2018). The Kurt Lewin 1935 approach-avoidance theory discusses the decision making toward goal-setting that has positive and negative effects that affected by environmental psychology. The approach-avoidance theory is used to examine positive or negative decisions between the independent variables those are tax complexity, tax compliance costs, tax rate and government transparency spending as well as tax education and tax knowledge in reducing tax payment of the SME taxpayers.

Tax complexity has always been a major reason why the taxpayer does not comply with the submission of taxes (Nkwe, 2013; Deyganto, 2018). The relationship between tax complexity and tax avoidance was examined by Nugent (2013). The result of the research shows a positive relationship between tax complexity and tax avoidance. Tax compliance is the actions of taxpayers to comply with all tax obligations that according to the taxation law to comply with taxation law. Complying with taxation laws incurs high compliance costs (Mahangila, 2017; Kelvin, 2017). The tax compliance cost is the cost incurred by the taxpayer when complying with the taxation laws (Eragbhe & Modugy, 2014). The components of tax compliance costs are tax liability and tax compliance administration in complying with taxation law such as agent fees (Mahangila, 2017). Alm (1988) examined that the tax compliance costs will lead to tax avoidance because taxpayers incur costs in complying with the taxation laws such as hiring tax agents, administration costs and paying the tax liability. Tax rate refers to the fairness of the tax system in charging the tax rate towards the taxpayers and the government transparency spending refer to the disclosure of spending in social and economic development by the government in the country. The results show that the transparency of government spending and fairness of tax rate will lead to tax avoidance activities in Nigeria. Education plays an important role in educating taxpayers to comply with taxation law (Kasipillai, Aripin & Amran, 2003; Kolodziej, 2011). Tax education refers to the tools that deliver the tax knowledge to taxpayers in understanding the taxation laws (Machogu & Amayi, 2013) and tax knowledge refers to the understanding level of taxpayers toward the taxation laws (Mohamad & Ali, 2017). According to Kolodziej (2011), the higher the level of tax knowledge of taxpayers the higher the chances of tax avoidance. This is because the taxpayers can use the loopholes in laws to reduce paying tax as they have enough knowledge and understand taxation laws implement in their country.

3. METHODOLOGY

The deductive approach is used to develop the hypothesis from the previous researchers' studies and theory. Theoretical framework is a guideline for the researcher to apply the existing theory to develop hypotheses in their studies. The independent variables are tax complexity, tax compliance costs, tax rate and government transparency spending as well as tax education and tax knowledge. The hypothesis was developed based on the research framework. This study is focusing on the factors that lead to tax avoidance activities in Penang. There are a total of four hypotheses to determine the factors in influencing tax avoidance activities amongst SME owners in Penang. First, the tax complexity refers to the complicated process to comply with the taxation law that leads to tax avoidance activities among the taxpayers. Next, the tax compliance costs refer to the costs incurred to comply with the taxation laws hence lead to the taxpayers involve in the tax avoidance activities. The tax rate and government transparency spending refer to the tax rate

charging and rewards to the taxpayer to influence the tax avoidance decision. Lastly, the tax education and tax knowledge refer to the level of understanding among the taxpayers towards the taxation law that leads to tax avoidance activities.

H1: There is a positive relationship between tax complexity and tax avoidance.

H2: There is a positive relationship between tax compliance costs and tax avoidance.

H3: There is a positive relationship between tax rate and government transparency spending and tax avoidance.

H4: There is a positive relationship between tax education and tax knowledge and tax avoidance.

There is a positive relationship between tax complexity and tax avoidance because the complicated taxation system leads to tax avoidance (Nugent, 2013; Kopczuk, 2007; Isa, 2013; Ariffin, 2016). Tax compliance costs lead to the issue of the tax burden on taxpayers. Thus, there is a positive relationship between tax compliance costs and tax avoidance because taxpayers do so with the aim to reduce their tax burden (Kim & Im, 2016; Atawodi & Ojeka 2012; Sapiei & Kasipillai, 2014; Alm, 1988).

There is a positive relationship between government transparency spending with the collected tax and tax avoidance activities because the taxpayers tend to know more about the government spending details in the country's social and economic development (Christians, 2014; Uadiale, Fagbemi & Ogunleye, 2010). Besides, the high tax rate for SMEs is one of the factors that lead to tax avoidance (Atawodi & Ojeka, 2012; Isa, 2013; Deyganto, 2018). According to Kolodziej (2011), Machogu and Amayi (2013) and Kirchler, Maciejovsky and Schneider (2001), the higher the level of tax knowledge of taxpayers the higher the chances of tax avoidance. Thus, showing the positive relationship between tax knowledge and tax education and tax avoidance.

Based on the latest data in Malaysia Statistical Business Register (MSBR) released by Department of Statistics, Malaysia (DOSM), the total number of SMEs in Malaysia in 2020 was 1,151,339 or 97.2% of total business establishments. This research is conducted during Covid-19 pandemic in 2020 and the total number of SME established in 2019 was 907,065 (SME Annual Report, 2018/2019). The top five states with the most number of SMEs in Malaysia are Selangor, WP Kuala Lumpur, Johor, Perak and Pulau Pinang. This study will focus on the SME owners in Pulau Pinang which account for 7.4% (66,921) of the SMEs in Malaysia. Based on this study, the appropriate sample size chosen from the population of this study is 420 which is in accordance to the theory of Krejcie and Morgan (1970). Random sampling is used in this study. There is a total of 66,921 SME in Penang state. 420 SME owners from Penang state were chosen randomly to assist in this study in answering the distributed questionnaire. The first and the last SME owner in the list will choose as the sample for this study. Using questionnaires was the only way to collect data and were distributed to SME owners from Penang. The data were processed using the Statistical Package for the Social Sciences (SPSS) version 25 and data editing and data cleaning were done to ensure the quality and accuracy of data before continuing to process using SPSS. Reliability analysis, descriptive analysis, validity test, normality test and inferential test are performed. There are 5 items to measure for each of the 5 variables using Likert scale from 1 to 5 (strongly disagree to strongly agree). The items for each variable are adapted from Tenidou, et.al (2015) because it is suitable and able to answer our research objectives. The items in the original questionnaire were modified to suit with our

local environment. It is also found that Tenidou, et.al (2015) has an effective tool to measure the 5 research variables in our study.

4. EMPIRICAL RESULT

The data was collected at the Penang state in 12 days for this study from 420 SME via Google Form since there has been a Covid-19 Pandemic that occurred around the world. All the 420 questionnaires were returned from this study (see Table 1). The result of the respondent rate of the study is 100%. The demographic was analysed from 420 respondents. The result shows that there is 45% of the respondents are male and 55% of the respondents are female. The highest percentage of the age group is from 26 – 35 that showing 67.6% from the respondents. Follow by the group of 36 – 45, 46 – 55, age less than 25 and age above 55 with a percentage of 13.1%, 8.6%, 7.6% and 3.1 % respectively. For education level, 0.5% of the respondents are Ph.D. qualification, followed by Master qualification 4.8%, 66.9% by Degree qualification, 15% by Diploma or STPM qualification and 12.9% by SPM or lower qualification. The local SME owners show a higher percentage compared to international SME owners which are 99.5% and 0.5% respectively. The 43.3% of respondents are micro-business size, followed by small-business size 34.8% and 21.9% by medium-business size. Among all respondents, 52.6% prepare the tax return by a tax agent, 39.5% prepare tax return by themselves, and 7.9% using other ways to prepare their tax return.

Table 1: Respondent profile (n=420).

Descriptive Items	Frequency	Percentage
Gender		
Male	189	45
Female	231	55
Total	420	100
Age		
Less than 25	32	7.6
26-35	284	67.6
36-45	55	13.1
46-55	36	8.6
56 and above	13	3.1
Total	420	100
Education		
SPM or Lower	54	12.9
Diploma/STPM	63	15
Degree	281	66.9
Master	20	4.8
PhD	2	0.5
Total	420	100
Nationality		
Local	418	99.5
International	2	0.5
Total	420	100
Business Size		
Small	146	34.8
Medium	92	21.9
Micro	182	43.3
Total	420	100
How you/ your company prepare tax return		
Own self	166	39.5
Tax agent	221	52.6
Other	33	7.9
Total	420	100

Tax avoidance is the dependent variable in this study. The average mean of tax avoidance is 3.3229 a high tax avoidance intention among the SME taxpayers in Penang state. Tax complexity is the first independent variable in this study. The average mean of tax complexity is 3.6348 also shows the highest mean value among the variables. Tax compliance costs is the second independent variable in this study. The average mean of tax compliance costs is 3.5771. The third independent variable in the study is tax rate and government transparency spending. The average mean of tax rate and government transparency spending is 2.9248 is the lowest mean value among the variables. Tax education and tax knowledge is the fourth independent variable in this study. The average mean of variable tax education and tax knowledge is 3.2872.

The reliability analysis in the Table 2 used to examine the properties of the measurement scale and the variable's consistency. All variables' Cronbach's Alpha value are exceeded 0.50. The variable of tax complexity shows the highest Cronbach's Alpha with 0.915 while the variables of tax compliance costs and tax rate and government transparency spending showing a good reliability result with 0.854 and 0.850 respectively. However, the reliability of variables tax education and tax knowledge and tax avoidance showing a questionable and poor acceptable reliability in the study with the Cronbach's Alpha of 0.601 and 0.594.

Table 2: Reliability analysis (n=420).

Variables	Valid Items	Cronbach's Alpha
Tax Avoidance	5	0.594
Tax Complexity	5	0.915
Tax Compliance Costs	5	0.854
Tax Rate and Government Transparency Spending	5	0.850
Tax Education and Tax Knowledge	5	0.601

The purpose of factor analysis test is to identify the relationship between the variables. The factor analysis will easily collapse the huge number of variables to become more manageable (Pallant, 2011). Kaiser-Meyer-Olkin (KMO) and Bartlett Test will be used in the factor analysis. The KMO with the variables more than 0.5 will prove that the factor analysis is valid in the study (Hair et. al. 2010). The KMO value of the study shows the range from 0.568 to 0.879. Hence, the KMO of this study is valid with a value that more than 0.5. The highest value of KMO in this study is tax complexity with the value of 0.879, followed by the tax rate and government transparency spending 0.838, tax compliance costs 0.832 and tax avoidance 0.705 respectively. The lowest KMO value in this study is tax education and tax knowledge which is 0.568. According to Bartlett (1954), Bartlett's Test of Sphericity is significant at $p < 0.000$. All the variables show the $p = 0.000$. Hence, Bartlett's test of Sphericity in this study was significant.

The multiple regression analysis will be used to determine the research question and to test the variables' results. According to Pallant (2011), multiple regression analysis is used to determine the relationship between independent variables and dependent variable. The coefficient R² (Table 3) is used to explain the multiple regression variance. Hence, the normality test and correlation test need to be done before multiple regression is performed. The Skewness and Kurtosis test will be used for the normality test in this study. The result of Skewness within +1 and -1 is accepted according to Hair et. Al.

(2006). All the variables in the skewness test are within +1 and -1 limit. Hence, the value of the kurtosis test is accepted. The correlation analysis is used to explain the relationship between independent variables and the dependent variable. The first correlation test is between tax complexity and tax avoidance which the $r=0.337^{**}$ or 33.7% respectively and the correlation is significant at 0.01 level. This means that there was a low positive correlation relationship between tax complexity and tax avoidance in preparing financial statements among SME taxpayers. The second correlation test is between tax compliance costs and tax avoidance which the $r=0.438^{**}$ or 43.8% respectively and the correlation is significant at 0.01 level. This means that there was a moderate positive correlation relationship between tax compliance costs and tax avoidance in preparing financial statements among SME taxpayers. Next, the third correlation is between tax rate and government transparency spending and tax avoidance which the $r=0.016$ or 1.6% respectively and the correlation is not significant at 0.01 level. This means that there was a negligible correlation relationship between tax rate and government transparency spending and tax avoidance in preparing financial statements among SME taxpayers. The last correlation is between tax education and tax knowledge and tax avoidance which the $r=0.272^{**}$ or 27.2% respectively and the correlation is significant at 0.01 level. This means that there was a negligible correlation relationship between tax education and tax knowledge and tax avoidance in preparing financial statements among SME taxpayers. The result of multiple regression analysis is where the R is the correlation of the independent and dependent variables with a value of 0.517. The level of independent variables affects the dependent variable show in R Square. The result shows that independent variables can be explained that 26.1% of the SME taxpayers are involved with tax avoidance activities and significant to ($p<0.000$). The results can be explained that tax avoidance by independent variables which are tax complexity, tax compliance costs, tax rate and government transparency spending as well as tax education and tax knowledge.

Table 3: Coefficient analysis (n=420).

Variables	Beta	p-value	t-value
Constant		.000	4.520
Tax Complexity	.145	.011*	2.558
Tax Compliance Costs	.329	.000**	5.733
Tax Rate and Government Transparency Spending	-0.16	.719	-.361
Tax Education and Tax Knowledge	.277	.000**	6.070

Dependent Variable: Tax Avoidance

Note: ** $p < 0.01$ * $p < 0.05$

The hypothesis testing using multiple regression shows variables of tax complexity, tax compliance costs and tax education and tax knowledge in this study are significant except the variable tax rate and government transparency spending.

H1: There is a positive relationship between tax complexity and tax avoidance.

The regression analysis result of variable tax complexity showed a significant and positive relationship with the dependent variable (tax avoidance). Beta value show at 0.145 and p-value at 0.011 ($\beta=0.145$, $p<0.05$). Meaning that when the tax complexity

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increase, tax avoidance also increases. Thus, hypothesis 1 was accepted and the findings indicate that tax complexity has a strong influence on tax avoidance in preparing financial statements among SME taxpayers in Penang state.

H2: There is a positive relationship between tax compliance costs and tax avoidance.

The regression analysis result of variable tax compliance costs has a significant and positive relationship with the dependent variable (tax avoidance). Beta value show at 0.329 and p-value at 0.000 ($\beta=0.329$, $p<0.01$). This meaning that when the tax compliance costs increase, tax avoidance activities also increases. Thus, hypothesis 2 was accepted and the findings indicate that tax compliance costs have a strong influence on tax avoidance in preparing financial statements among SME taxpayers in Penang state.

H3: There is a positive relationship between tax rate and government transparency spending and tax avoidance.

The regression analysis result of tax rate and government transparency spending has an insignificant and negative relationship with tax avoidance. Beta value show at -0.16 and p-value at 0.719 ($\beta=-0.16$, $p>0.05$). The result explains that the tax rate and government transparency spending does not lead to the tax avoidance activities among SME taxpayers in Penang state. Hence, we failed to accept the hypothesis 3 and it is not supported.

H4: There is a positive relationship between tax education and tax knowledge and tax avoidance.

The regression analysis result of tax education and tax knowledge has a significant and positive relationship with the dependent variable (tax avoidance). Beta value show at 0.277 and p-value at 0.000 ($\beta=0.277$, $p<0.01$). This meaning that when tax education and tax knowledge increase, tax avoidance also increases. Thus, hypothesis 4 was accepted and the findings indicate that tax education and tax knowledge have a strong influence on tax avoidance in preparing financial statements among SME taxpayers in Penang state.

5. DISCUSSION AND CONCLUSION

According to Henseler, Ringle and Sinkovics (2009), the acceptable value of R Square is 0.25 and above. The result of R Square in the multiple regression analysis shows the value of 0.261 or 26.1%. It shows a weak acceptable relationship between the independent variables and the dependent variable. The lowest mean score value from this study is the tax rate and government transparency spending with the value of 2.9248. Tax complexity, tax compliance costs, tax rate and government transparency spending as well as tax education and tax knowledge have a strong influence on tax avoidance in preparing financial statements among SME taxpayers in Penang state.

Hypothesis on tax complexity was accepted and show a positive and significant relationship with tax avoidance. A study conducted by Nugent (2013) shows tax complexity is significant toward tax avoidance. The second hypothesis on tax compliance costs was also accepted and show a positive and significant relationship with tax avoidance activities. Alm (1988) examined that tax compliance costs will lead to tax avoidance. The third hypothesis is the tax rate and government transparency spending shows a negative and insignificant relationship with tax avoidance activities. The study

conducted by Kim and Im (2016) mentioned that government transparency spending and higher tax rate does not lead to the issue of tax avoidance. Thus, can be concluded that the taxpayers are satisfied with the tax rate set by the government. Besides, the Malaysian new government has giving good rewards to the taxpayers such as increase the Matriculation quota, subsidies for petrol, exempted the toll fee for motorcycles, KWSP skim for housewives, etc. Besides, the rapid development in Penang state successfully builds the trust and confidence from the taxpayers in Penang and to believe that the collected tax will be used wisely for the state and social development. Taxpayers are confident that the collected tax spends wisely for the state and social development in Penang. Hence, we failed to accept the third hypothesis in this study. The last hypothesis of this study which is tax education and tax knowledge was accepted and show a positive and significant relationship with tax avoidance activities. According to Kasipillai, Aripin and Amran (2003) and Kolodziej (2011), mentioned that the higher the level of tax education and tax knowledge the higher the chances of tax avoidance. Tax compliance costs can be considered as the most significant factors that lead to the tax avoidance activities among the SME taxpayer in Penang state. The variable of tax compliance costs shows a higher beta among the four variables with the value of 0.329. The second significant variable in this study is tax education and tax knowledge followed by the tax complexity with the beta value 0.277 and 0.145 respectively. However, the negative beta value of tax rate and government transparency spending variable with the beta value of -0.160 and show that there is no significant relationship with the tax avoidance activities among the SME taxpayers in Penang state. Therefore, the research model in this study is found to be acceptable and suitable.

Taxpayers need to attend more seminars and classes to gain more tax knowledge to minimize the mistake during tax submission. Taxpayers must also keep updated with the current income tax rules and regulations to minimize the tax penalty and compound causes by the tax default. Besides, the accountants and tax agents also play an important role in educating the taxpayers to comply with the taxation laws. Accountants and tax agents should deliver and explain to their clients the impact of tax avoidance. Accountants and taxpayers can help their clients in solving the taxation problems such as guidelines on tax computation preparation and tax incentive applications but not using the loopholes in the taxation laws to help their clients to reduce the tax payment. To increase the taxpayer's awareness to comply with the taxation laws by conducting more classes and seminars, compulsory taxation classes at the primary and secondary school level, user-friendly e-filing system, simplify the e-filing process, tax rate needs to be reformed to reduce the tax burden of taxpayers and to encourage the taxpayers to pay the tax especially during the Covid-19 pandemic, more field audits, a higher rate of penalty, government's rewards such as tax incentive packages, upgraded education and public transportation system, etc to prove that the collected tax was spent wisely by the government and to reform the tax policy to reduce the avoidance activities among tax taxpayers in Malaysia. A bigger sampling size would make the study more accurate and with a valid result and more variables can be used for the study such as the firm's size, tax incentive packages, institutional ownership, etc.

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