

## **INTRINSIC AND EXTRINSIC MOTIVATION IN TAX COMPLIANCE BEHAVIOUR**

Noorliana Safian <sup>1</sup>  
Suhaila Abdul Hamid <sup>2</sup>

<sup>1</sup>Universiti Teknologi MARA

<sup>2</sup>Universiti Sains Islam Malaysia

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**Abstract:** *Tax compliance is a worthy area to be examined in Malaysia since government relies on tax revenue to fund its operations. Records from the Inland Revenue Board of Malaysia indicates that tax compliance is still an issue. Past studies in tax compliance indicate that many factors can influence the tax compliance behaviour of taxpayers. However, studies on intrinsic and extrinsic motivation in complying with the tax law are still scarce especially in Malaysia. This paper attempts to provide an overview into intrinsic and extrinsic motivation in complying with the tax law. A review of past relevant studies is presented and it can be concluded that intrinsic and extrinsic motivations can influence tax compliance behaviour. The review suggests that intrinsic motivation in tax context is normally associated with tax morale. Contrarily, extrinsic motivation in tax compliance is generally discussed as providing a positive inducement to increase tax compliance.*

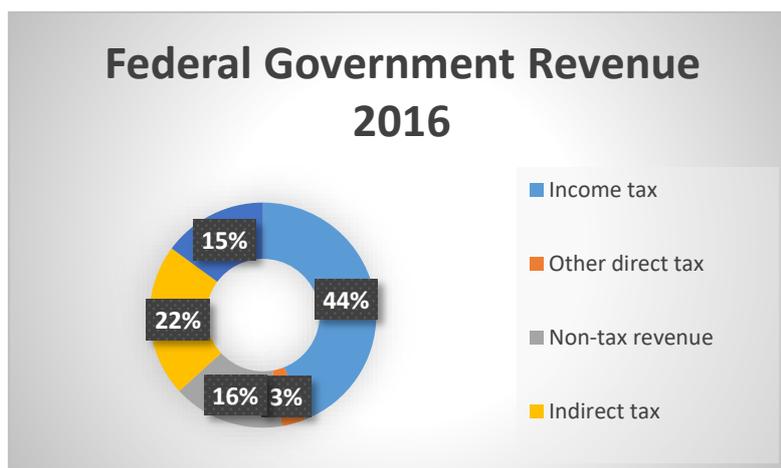
**Keywords:** *Tax compliance, Motivation, Intrinsic, Extrinsic, Paper review*

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### **Introduction**

A tax system has important roles in a government. It is used not only as a tool to collect income for the government but also a mechanism to ensure government policies are being performed. Thus, tax compliance issues are worthy to be discussed especially when the government relies on tax income to fund its operation such as in Malaysia. Based on a recent report published by Ministry of Finance, 2016 indicates that 44% of Federal Government Revenue comes from income tax.

**Figure 1.1: Federal Government Revenue, 2016**



Source: Ministry of Finance, 2016

Generally, previous tax compliance studies debated the issues of tax compliance by using either economic approach or socio-psychological approach (Alm et al., 1995; Andreoni et al., 1998; James and Alley, 2002). While economic approach focuses on tax gap, psychological approach on the other hand, stresses on the importance of voluntary compliance. The concentration of economic approach is only on the trade-off between benefits of evading and the risk of detection. This is in contrast from the psychological approach which in the premise that compliance behaviour is constructed by various factors and not focuses on economic factor solely.

Individual income tax is a vital source of income for the Malaysian Government. The Government through the Inland Revenue Board intensified their efforts every year to accomplish high tax collection. The efforts prove succeeded when the amount of income tax collection showed a gradual increment as indicated in Table 1.1. It increases from 1.86% to 23.79% with the highest increment in 2008.

Even though there is an increment, the OECD report in 2016 is in the opinion that, the trend of tax revenue collection in Malaysia does not show significant changes. This view could be supported by looking at the number of registered taxpayers. It is reported that in 2013, out of 12 million labour force, there is only 6.4 million registered individual taxpayers, which constitutes only half off the total workforce. Interestingly, from that volume, only 1.8 million workforces pay tax or it can be concluded that only 15% of all salaried individuals in Malaysia pay their taxes. In a more recent statistics, provided by Ministry of Finance (2017), a slight increase is observed in the number of taxpayers whereby out of 14.6 million total workforces, 2.1 million pay their taxes. To conclude between 2013 and 2017, only 0.3 million increments recorded which is still considered as low.

Given the facts of low compliance among the Malaysian taxpayers, this study attempt to explore the role of intrinsic and extrinsic motivation in understanding tax compliance behaviour. To date, the study that analyses the role of intrinsic and extrinsic motivation in complying with the tax law is still scarce especially in the Malaysian context. Therefore, this paper attempts to provide an overview of intrinsic and extrinsic motivation in tax compliance behaviour.

**Table 1.1: Individual Income Tax Collection from 2005-2015**

<b>Year</b>	<b>Collection (RM)billion</b>	<b>Percentage increase/decrease</b>
2015	RM28,276.97	6.09%
2014	RM26,654.91	8.32%
2013	RM24,607.91	7.17%
2012	RM22,961.85	18.46%
2011	RM19,383.02	8.89%
2010	RM17,800.00	14.32%
2009	RM15,570.00	8.5%
2008	RM14,350.00	23.79%
2007	RM11,592.18	11.36%
2006	RM10,409.65	1.86%
2005	RM10,220.00	

Source: Inland Revenue Board Annual Report 2005-2015

The objective of this paper is to provide a review of past studies on some selected variables in tax compliance which are intrinsic and extrinsic motivations. Following this introduction section is the review of tax compliance studies. Then the evidence on intrinsic and extrinsic motivations in relation to tax compliance studies is discussed. Lastly, the findings and conclusion are presented. Since this is an overview study, the scope of this paper is in the past studies since 1979 up to 2015. The studies only limit to studies that explore the role of intrinsic and extrinsic motivation towards tax compliance behaviour.

## **Literature Review**

### ***Tax compliance studies***

Generally, previous tax compliance studies debated the issues of tax compliance by using either economic approach or socio-psychological approach (Alm et al.,1995; Andreoni et al., 1998; James and Alley, 2002). The economic approach focuses on the benefits of evading and the cost of complying which can be considered a narrow based perspective. Alm (1991) argues that while audit and penalty rates affect compliance, but it does not explain the adherence by taxpayers to tax rules. It is assumed that individuals are selfish and will wish to maximize their personal income and wealth. They will not comply with the tax system unless the benefits of doing so outweigh the cost of doing so. The formal theoretical economic model of tax evasion was pioneered by Michael Allingham and Agnar Sandmo about 45 years ago. They adapted Becker's model of economics of crime. Becker's, (1974) model argues that individuals make a rational decision before committing a crime by choosing among the different types of risky or safe options. Allingham and Sandmo (1972) then adopted the concept of crime and punishment into the Expected Utility Theory of Taxation and has become a benchmark in economic-based tax compliance studies (Andreoni et al., 1998).

Contrarily, the socio-psychological approach assumed that individuals are not necessarily selfish and seek to maximize their utility as portrayed in the neo-classical perspectives but are often motivated by many other factors such as social norms, morality, altruism and fairness. This view is consistent with the writings of Andreoni et al. (1998) which stresses the idea that psychological (guilt, shame, regret, envy, anger, sense of duty), demographic, social, and moral factors should be integrated into standard economic models. James and Alley (2002) also have a similar thought that individual is not independent, self-centred but they also interact with other human beings in accordance with the attitudes, beliefs, norms and roles.

Within the last 10 years, the focus on socio-psychological studies came from various themes for example ethics (See for example Alm & Torgler, 2011; Ho & Wong, 2008; Lisi, 2014; MacGregor & Wilkinson, 2012; Maciejovsky & Schwarzenberger, 2012), tax knowledge (See for example Mei, Carrol, & Chin-fatt, 2012; Saad, 2012; Savitri, 2015), tax fairness (See for example Khasawneh, Obeidat, & Al-Momani, 2008; Mei et al., 2012), geographical distance (See Loureiro, 2014), social norms (For example, Bobek and Hageman, 2015), religion (See for example, Raihana Mohdali and Pope, 2014), gender (See for example, Chung J. and Viswanath Umashanker Trivedi, 2003; Jeyapalan Kasipillai and Hijatullah Abdul Jabbar, 2006), ethnicity (See for example, Jeyapalan Kasipillai and Hijatullah Abdul Jabbar, 2006), attitude (See for example, Hays, 2000), self-perception (See for example, Feld and Larsen, 2012), government policies (See for example, Feld and Larsen, 2012), reward (See for example, Bazart and Pickhardt, 2011; Fochmann and Kroll, 2016), bureaucracy and corruption (See for example, Picur and Riahi-Belkaoui, 2006) and service quality (See for example, Andreas Enni Savitri, 2015).

### ***Motivation***

According to Campbell and Pritchard (1976), motivation refers to a force within someone that pushing him or her direction, intensity and persistence of voluntary behaviour. This definition is consistent with the definition proposed by Lambrou, et al. (2010) in which motivation is defined as the process that accounts for individual's direction, intensity and perspective of efforts towards attaining a goal. Robbins et al. (2010) posited that motivation is the process that accounts for an individual's intensity, direction and persistence of effort toward attaining a goal. This means that motivation determines the amount of effort a person puts in his or her work, the direction to which those efforts are geared and a measure of how long a person can maintain effort.

Direction implies that the motivation is goal-oriented, not random. Intensity is the amount of effort allocated to goal attainment. Motivation also involves a level of persistence to sustain the effort over a certain period of time. The level of persistence varies. Employees may sustain their efforts until they reach their goal, or they may give up beforehand. Note that motivation can come from both external and internal sources (Deci and Ryan, 1985).

The study on motivation has been done since the 1930s. Among the early theories of motivation are Maslow's Hierarchy of Needs (Maslow, 1943), Theory X and Y (McGregor, 1960) and Herzberg's Two Factor Theory (Herzberg, 1959). The evolution of motivation work give birth to the contemporary theories of motivation such as McClelland Theory of Needs (McClelland, 1965), Goal Setting Theory (Locke, 1996), and Equity Theory (Adams, 1963). Although the abovementioned theories have discussed motivation from various angle and dimension, theorist like Herzberg to Hackman and Oldham to Deci and Ryan, all categorize motivation into two broad categories, which are intrinsic and extrinsic. Herzberg's Theory (Herzberg, 1959) is in similar view with Maslow (1943) which views intrinsic and extrinsic motivation as combining additively. Once the frame of extrinsic motivation is satisfied, intrinsic motivation can lead to high levels of satisfaction and performance. Hackman, et al. (1976) suggests that extrinsic motivation can add to internal motivation. Meanwhile Amabile (1993) is in the opinion that, extrinsic and intrinsic motivation do not mix well. In addition to that, other psychologists have posited two types of motivation theories: Dualism and Multifaceted theory (Reiss, 2004). Dualistic theories divide motivation into two types: intrinsic and extrinsic. Psychologists had

associated the survival needs with extrinsic motives and psychological needs with intrinsic motives.

Deci (1975) in his book *Intrinsic Motivation* wrote that extrinsic motives arise from “tissue needs” (i.e the body) whereas intrinsic motives arise from the central nervous system (i.e the mind). Various scholars have a different insight on intrinsic and extrinsic motivation, but they are similar in the senses that, they agree that individuals motivation can be grouped into these two categories.

Intrinsic motivation derives from within the person. It refers to doing something for its own sake or doing something because it is inherently interesting and enjoyable (Reiss, 2012; Ryan and Deci, 2000). It arises from the person’s feelings about the activity and they are necessarily bound up to the work itself (Amabile, 1993). Vallerand et al.,(1992) posited the existence of three types of intrinsic motivation which are intrinsic motivation to know, intrinsic motivation to accomplish things and intrinsic motivation to experience stimulation. Intrinsic motivation to know refers to engaging or participating in an activity for the pleasure and satisfaction that one experiences while learning and exploring. Intrinsic motivation to accomplish things refers to an engaging in an activity for the pleasure and satisfaction that one experience when one is attempting to accomplish something or create something and lastly, the intrinsic motivation to experience stimulation pertaining to when one engage in an activity to experience pleasant sensations. In the scope of work related behaviour, examples of intrinsic motivations are achievement, accomplishment, challenge and competence which are derived from performing one’s job well (Afful-Broni, 2004).

On the other hand, extrinsic motivation refers to the pursuit of an instrumental goal or doing something because it leads to inseparable outcome (Reiss, 2012; Ryan and Deci, 2000). Extrinsic motivators include anything from an outside source that is intended to control the initiation of the performance of work. If in the context of job scope, example of extrinsic motivation among others are promised reward, praise, critical feedback, deadlines, surveillance or specifications on how the work is to be done (Amabile, 1993). Individuals with extrinsic motivation may opt to perform and activity even though they do not need it for pleasure.

### ***Intrinsic motivation in influencing tax compliance behaviour***

There are a number of studies that associates intrinsic motivation through a tax morale concept (For example, Cummings et.al., 2006; Torgler, 2005; Frey, 1997). Tax morale is defined as the intrinsic motivation to pay taxes (Torgler 2003a, 2003b, 2004; Cummings et al., 2006; Torgler and Schneider, 2006). Individuals comply voluntarily due to the belief to contribute to the society or, they might feel guilt or shame if they fail to comply. Those who have high tax morale comply due to reciprocal motivations, that is, they will pay taxes in exchange for the benefits provided by the state (Luttmer and Singhal, 2014). The feelings of pride and positive self-image that often associated with honesty, civic duties and altruism towards others are among the forms of intrinsic motivation in tax compliance (Andreoni et al., 1998).

The tax morale theme has been well researched by Torgler (Torgler, 2002, 2003a, 2004b, 2005, 2007; 2006). Torgler analyzed the influence of tax morale towards tax compliance from various angle and perspectives. Attempt were made by Torgler to study tax morale from cultural perspectives (Alm and Torgler, 2006; Torgler, 2003, 2004b, 2005; Torgler and Schaltegger, 2006; Torgler and Schneider, 2006) and the influence of variables like institutions, religiosity,

democracy, trust, fiscal policy, corruption, governance quality to tax morale (Torgler, 2003b, 2003c, 2004b, 2005, 2007). Some researcher have also examined the influence of various variables towards tax morale such as public spending inefficiency (Barone and Mocetti, 2011), policy maker's effectiveness (Anno, 2009), trust (Aguirre and Rocha, 2010), tax administration (Pommerehne and Frey, 1992), tax enforcement (Fillipin, Fiorio, and Viviano, 2013), decentralization (Guth, Levatti and Sausgruber, 2005) and religion (Raihana and Pope, 2014).

Generally, all studies that explore different variables under the tax morale theme agree that tax morale possesses a significant influence on tax compliance behaviour. Aspect such as trust, power, perceptions of a government response, culture, decentralization, direct democracy was proven empirically to have a significant effect on understanding tax compliance behaviour. (See Table 1.1)

### ***Extrinsic motivation in influencing tax compliance behaviour.***

Past research that examined the influence of extrinsic motivation in compliance behaviour agreed that extrinsic motivation plays a significant role in tax compliance behaviour (See for example, Alm et al, 1992; Bornman and Stack, 2015; Dwenger et al., 2014; Falkinger and Walther, 1991; Feld and Frey, 2007; Frey, 1997; Sutinen, 1999).

In Dwenger et al. (2014), intrinsic and extrinsic motives to tax compliance behaviour were studied in the context of local church in Germany. The study utilized data from church district records containing true church taxes paid by each individual and state income tax records containing true taxes owed. The findings of the study revealed that deterrence and reward incentives have a significant effect on compliance behaviour. The findings is consistent with the findings of Bornman and Stack (2015) which found that rewards are most strongly favoured as a strategy to encourage tax compliance. In a similar vein, Rillstone (2015), through the findings of interview study found that, rewards could be a more effective means to improve compliance.

Alm et al. (1992) investigated the role of positive inducement on compliance behaviour via an experimental method. The results confirmed that positive inducement has a significant and positive impact on compliance behaviour. Feld (2009) expressed a similar perspective; rewards seem to be perceived as a good acknowledgement for being a good taxpayer. The reward may take in a form of direct monetary payment or a gift. A gift that Feld (2009) regards as an exchange of relationship between taxpayer and the state. A gift may be in the form of free entry to museums, exhibitions, and other cultural activities undertaken by the state or as a reduction (say, 50 percent) on all public transport (Feld and Frey, 2009). When previous studies focused on rewards and penalties as a forms of extrinsic rewards, the study of Sutinen (1999) offers different perspectives. In this study, the researcher perceives social influence as another form of extrinsic motivation. Enforcement authorities and peer groups are examples of social influence that affect the compliance behaviour. The study demonstrates past evidence that support an individual is more non-compliant the more his community and peer groups are non-compliant.

To the best of the author's knowledge, there is only two studies that explores the role of extrinsic motives towards tax compliance behaviour in which both of them analyse the role of rewards in influencing tax compliance behaviour. (See Rillstone, 2015; Bornman and Stack, 2015). Both

of the studies agree that the use of rewards could be a means to improve tax compliance behaviour.

## Methodology

Overall, three databases are used to accessed the articles which are Google Scholar, Scencedirect and Ebscohost. As there is a limited study that explores the role of intrinsic and extrinsic motivation in predicting tax compliance behaviour, 18 articles from 1979 to 2015 were reviewed. The details on the database and the articles is presented in Table 1.1.

**Table 1.1 Summary of review on motivation, intrinsic and extrinsic motivation to tax compliance behaviour**

Database	Author	IV	DV	Method	Findings
<b>Intrinsic &amp; Extrinsic motivation</b>					
Google Scholar	Dwenger et al (2014)	Extrinsic motivation Intrinsic motivation	Tax compliance	Field experiment	a significant fraction of individuals comply with the zero deterrence baseline where compliance should be zero absent intrinsic motivations
Google Scholar	Vallerand & Bissonnette (1992)	Intrinsic Extrinsic Amotivational	Behaviour	Survey (n=1032)	individuals who persisted in the course had reported at the beginning of the semester being more intrinsically motivated, more identified and integrated, and less motivated
<b>Extrinsic motivation</b>					
Google Scholar	Rillstone (2015)	Rewards	Tax compliance	Interview	use of rewards could be a more effective means of improving the compliance behaviour of non-compliant taxpayers,
Google Scholar	Bornman & Stack (2015)	Rewards	Tax compliance	Survey (n=176)	rewards had a positive effect on tax compliance behaviour
Ebscohost	Landen & Willems (1979)	Extrinsic rewards	Motivation	Survey (n=26)	Desirable activities when required can become undesirable
<b>Intrinsic motivation</b>					
Science direct	Kogler et al (2013)	Trust	Tax compliance	Experiment (n=329)	High trust lead to tax compliance
Google scholar	Wahl et al (2010)	Trust in authorities Power of authorities	in of	Experiment (n=124)	-trust in authorities and the power of authorities differently affect the motivation to comply on a voluntary or an enforced basis.
Google Scholar	Aguirre & Rocha (2010)	Perceptions on government response	Tax morale	Lationobaromatro	a strong correlation between tax morale and the perception that money collected is well spend and voice.

Science Direct	Torgler & Schneider (2006)	Culture & institutions Political attitudes & religiosity	Tax morale	WVS & EVS	trust in the legal system, government, and parliament; national pride; and pro-democratic attitudes all have a positive effect on tax morale
Google Scholar	Guth et al 2005	decentralization	Tax morale	Experiment (n=6)	people's propensity to pay taxes is higher in a decentralized tax structure
Science direct	Torgler (2005)	Direct democracy	Tax morale	Survey data (ISSP 1998)	direct democratic rights have a significantly positive effect on tax morale.
Google Scholar	Murphy (2004)	Trust	Tax compliance	Survey (n=2292)	if taxpayers feel poorly treated by a tax authority as a result of their infractions (innocent or otherwise), this can lead to a decrease in taxpayer trust.
Science direct	Torgler (2004)	Trust in legal system Trust in government Democracy Satisfaction	Tax morale	WVS data	The results indicate that trust in government and the legal system and the satisfaction with national officials have a significant positive effect on tax morale.
Science Direct	Torgler (2003)	Trust	Tax morale	Survey (WVS)	trust in government, pride, and religiosity have a systematic positive influence on tax morale
Proquest	Torgler (2003)	Trust in political and legal system	Tax morale	WVS & TOS	Trust in public officials and the legal system has effect on tax morale

## Findings and Conclusion

Based on the review, the study that explores the role of intrinsic and extrinsic motivation is still very limited. There is a large room to explore the effect of these variables to better understand the compliance behaviour among the taxpayer. To date, there is only one study that explores the role of intrinsic and extrinsic motivation in a single framework to understand tax compliance behaviour. Therefore it is suggested that future studies incorporate these two variables to better understand tax compliance behaviour. Furthermore, the analysis of each component of motivation (i.e intrinsic and extrinsic) is also very limited. For intrinsic motivation, studies confirmed the use of rewards in improving tax compliance behaviour. On the other hand, intrinsic motivation or tax morale also proved a significant influence towards tax compliance behaviour.

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