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Factors that Influence the Taxpayers' Perception of the Tax Evasion: Evidence from Pakistan

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<p>Manzoor Ahmed Assistant Commissioner, Sindh Revenue Board, Government of Sindh manzoor.memon@iba-suk.edu.pk ORCID: 0009-0007-3551-2195</p> <p>Misbah Bibi MPhil Economics, National college for Business Administration and Economics, Lahore. misbahjaved027@gmail.com</p> <p>Muhammad Ali MA Development Studies (IPED), International Institute of Social Studies (ISS), Erasmus University Rotterdam, the Netherlands. muhaqiq.ali@gmail.com</p>	<p>Abstract</p> <p>The research study's aim is to investigate and identify factors influencing tax evasion (Tax system, Tax knowledge, Tax fairness, Tax Morale, and Tax compliance cost). It also explores the process of paying taxes to the government. Further, the research study indicates the significance of paying taxes timely, making people responsible citizens. On the contrary, it also diagnoses loopholes of tax evasion and the people who enjoy tax evasion and avoid paying taxes. The questionnaire was distributed among people from different professions of various ages, genders, marital status (single, married), occupations, and salary levels to obtain their responses and points of view from major cities of Pakistan, i.e., Karachi, Lahore, and Islamabad approached for surveying regarding the research topic. The result of the study will contribute to the taxpaying people who pay taxes to the government, such as professors, teachers, advocates, doctors, drill miler owners, wheat miller's owners, ice millers owners, whole sealer shop keepers, medical storekeepers, state agency dealers, and others. For the study, 394 people were chosen using a convenience sampling method, and the questionnaire was analyzed using SPSS Software. Then, this study was studied and interpreted using Smart PLS 3.2.9 version, where the researcher performed a Partial Least Squares (PLS) analysis, a two-step process. The researchers found the measurement and structural model results of the study. This study found that tax compliance has a positive influence, while tax fairness, tax knowledge, tax morale, and tax system have a negative influence on the perception of taxpayers on tax evasion. Specifically, tax compliance appeared as the primary factor that positively influenced the taxpayers' perception of tax evasion. Hence, government and other departments should prioritise the efforts to enhance tax compliance compared to other factors. However, other factors, i.e., tax fairness, tax knowledge, tax morale, and tax system, negatively influence taxpayers' perception of tax evasion; these factors also need the attention of the authorities. The study also explained and highlighted factors to increase the tax system and suggested factors to motivate people about the taxpaying system and decrease the ratio of tax evasion in our beautiful country, Pakistan. Pakistan is a developing country, and changing taxpayers' perceptions of tax evasion would benefit the country and, ultimately, boost the economy.</p>
<p>Keywords:</p>	<p><i>Tax Evasion, Taxpayers' perception, Tax system, Tax Morale, Tax Knowledge, Tax Fairness, Compliance Cost</i></p>



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Introduction

Taxes play a pivotal role in every country; the public does not like paying taxes but considers them a burden. Many persons, groups, and organisations engage in tax evasion, which is unlawful. Tax evasion often involves deliberate misrepresentation of earnings to escape paying taxes and be free from any monetary charges and responsibilities. Usually, the person presents a dishonest report of his assets and income. Further, it includes disclosing fewer profits than the original values. (Slemrod & Bakija, 2017).

Tax evasion is a practice typically found in the unregulated financial system. Tax evasion is the amount that is unreported earnings by people, groups, and organisations. Tax evasion is different from tax avoidance. Tax avoidance is the legal use of tax policies to lower one's tax load. Both tax evasion and avoidance may be considered varieties of tax noncompliance. Tax noncompliance is a collection of activities harmful to the government's taxation system. Tax avoidance includes noncompliance detrimental to the government system, and tax evasion is unlawful for tax accountabilities. (Salverda, Nolan, & Smeeding, 2009; Webley & Adams, 2001).

This study is conducted to disclose the factors affecting taxpayers' perception of tax evasion. This research explores the aspects of tax evasion after creating the SAS "Self-Assessment System." Five elements of tax evasion have been tested, including the tax system, tax morale, tax knowledge, tax fairness, and compliance cost. This study found that tax avoidance is affected. The results also disclosed that the tax system is important for the government as well as taxpayers; the government should give tax education to taxpayers, simplify the tax system, and help taxpayers develop the behaviour of paying taxes to the government. Self-motivation is the key force behind paying taxes among individuals. Tax is the required payment of authority for a specific period (Adams & Webley, 2001). Individuals who disobey and commit unlawful activities also support tax evasion. Few people also avoid paying taxes because they do these practices due to a lack of knowledge, simply following the law, and thinking they will not be charged with crime and punishment (Akram, Iqbal, & Mughal, 2012).

The taxpayers aspire to earn many profits from tax evasion. Whereas if there can be no tax obligation, the money paid for taxes may be used for the growth of the self-actualisation of different requirements (Adams & Webley, 2001). Tax evasion defines a choice of unfavourable and detrimental activities to the country's tax system and classification. These contain tax avoidance, which denotes reducing taxes by legal income, and tax evasion is compared to the criminal illegal and non-payment of tax responsibilities. Groups that do not pay taxes include tax activists and tax resisters. Tax activists typically do not take the position that the tax laws and regulations are themselves illegal or do not apply to them, and they are more concerned with not paying for the government policies that they compete against. A tax resister is someone who refuses to pay the legal tax obligation of the government.

Tax protesters differ from tax resisters in that they refuse to pay taxes out of moral opposition to taxation in general or in protest against a government or its policies, not because they believe that the tax rule or regulation is unconstitutional in and of itself. A sizable and organised culture in the United States embraces such beliefs. Tax protesters are also present in other nations, whereas tax activists work to advance, impede, direct, or interfere in social, political, or economic affairs to bring about social change (SaadNatrah, 2014). Tax activists are just those who pay their taxes on time. (Allingham & Sandmo, 1972) Tax utility is a crucial boundary of tax approach tax policy everywhere globally. Taxpayers who intentionally omit information from their tax returns, such as a single person who would not disclose any cash-based income or chance income, engage in tax evasion.

This research aims to either investigate or acquire the relevant facts, as well as associate knowledge about the factors that influence tax evasion. However, which factors are essential and unimportant in tax evasion for countries' rules and regulations? The researcher has read the literature of different authors and concluded that there is a lack of knowledge about the factors of tax evasion. As a society, we face many daily expenses and many financial vicissitudes because life combines joy and worries. Paying the tax is the most critical sign of being a civilized member of society and the symbol of a good citizen because the government has provided facilities to the population of people of that city or the people of Pakistan, such as free education to the people, free health care, and so on. Tax evasion is avoiding tax or not paying tax to the government; it is illegal to also prohibited by law and regulation that the government or the tax system of that country can take action against that individual by the article law and rule of conduct then the group of people can be punished. The result of this research is beneficial for the government as well as the public who is paying taxes to the government. It is for the government to make new policies that attract taxpayers or motivate the public to pay taxes to the government.

Literature Review

This study sought to understand how taxpayers perceive tax avoidance. It offers a theoretical and empirical literature assessment. The theoretical assessment covers the ideas and theories of tax evasion, while the empirical study deals with previous studies on tax evasion.



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Tax evasion is considered as illegal because it involves deliberately avoiding to pay taxes which could be possible when an individuals' misrepresent the income or shows the less income to avoid paying taxes (Alqtish, Alqirem, & Kasem, 2018; Oluyinka, Adekunle, & Adeleke, 2021)

This study explores the literature on different training, education, and research about taxpayers' perceptions of tax evasion. Besides, all theories help and try to recognize the issue and discover studies on tax evasion or, in other words, what other researchers think about tax evasion worldwide. Globally, the government receives taxes, and in return, the government facilitates the general public, including infrastructure and safety, roads, airports, seaports, and railways. Almost all countries have the highest earnings from taxes, which are collected from every citizen through direct or indirect taxes, by facilitating financial institutions, giving safety to the highest-earning corporations for selling the products and services to the public and mentioning some rules of the economic system, which allow the company to pay regular taxes (Lorato, Sendaba, & Tadesse, 2024). Numerous findings and results exist on the influence of tax awareness or tax education on tax evasion and some researchers discovered that awareness does not influence tax compliance, while others claim that lack of education greatly influences tax evasion (Kasipillai, Aripin, & Amran, 2003). The researcher discovered that awareness about taxes has no role in the decision-making process about tax evasion (Alqtish, Alqirem, & Kasem, 2018). In their study "Reasons for Tax Avoidance and Evasion: Reflections from Pakistan," they discovered five tax evasion factors, including the tax calculation of uneducated taxpayers. Most taxpayers are unaware of the tax filing returns and other compliance statements and documents. A taxpayer's education can assist the taxpayer in enhancing tax morale (Mughal & Akram, 2012).

Previous studies on perception of taxpayers evasion attitude show that individuals' who pay taxes because they perceive that tax system as trustworthy and fair due to adhere to fiscal policies (Carrilo, Castro, & Scartascini, 2021). (Richardson G, 2006) discovered that the relationship between government legitimacy and tax evasion effectiveness is negative.

Tax Evasion

UKRC's "United Kingdom Royal Commission" on profits taxation and incomes has explained the term 'tax evasion,' "it denotes all those activities responsible for a person not paying the tax that the existing law charges his income. The taxpayer's act of wrongdoing may range from making a deliberate fraud as quid pro quo and failing to pay tax at the proper time." Tax evasion refers to "all those illegal activities or practices which a taxpayer adopts to avoid him/her-self from taxation. For this purpose, taxable income/profits liable to tax or other taxable activities are concealed, tax-reducing factors like expenditures, exemptions, or other tax credits are knowingly and willfully overstated, and the amounts received or the source of income misrepresented." All over the world, taxes, as well as tax evasion, are prominent problems. In another research carried out in Tanzania, the findings were that when tax authorities start the campaign for paying taxes to the government, taxpayers hide in the bushes.(2006).

Factors Influencing the Taxpayer's Perception

Many factors affect the taxpayer's perception. Five major factors are the tax system, Tax Morale, Tax knowledge, tax fairness, and tax compliance cost.(Awan & 2014)

Tax Knowledge

Tax knowledge means understanding tax rules and regulations or keeping awareness about taxes and regulations. Tax systems knowledge helps the government increase the number of taxpayers who pay taxes according to tax regulations as well as the laws of the country. Generally, people have limited information about the government's actual cost and expenses for providing the facilities to the public by the government. Nowadays, most taxpayers ask tax experts to give services because they do not have authentic knowledge about the tax system. One of the important ways to enhance people's responsiveness and awareness about tax rules and regulations is to impart tax knowledge to taxpayers.(Fjeldstad & Semboja, 2001). Government and society share vital knowledge, which inspires individuals to pay their obligations and register themselves as reported taxpayers who pay taxes correctly. Most people do not have much understanding of taxes and regulations. From tax knowledge, the researcher indicated from research that there could be a link between legal guidelines and taxation. Additionally, obey the tax rules and regulations.(R. G. , 2006) Numerous researchers have discovered that tax knowledge plays a massive role in the government's increasing tax revenues. Tax knowledge could hypothetically inspire taxpayers to be cautious about paying taxes. Henceforward, we have hypothesized that there may be a critical connection between tax knowledge and tax compliance.

"H₁. Tax Knowledge has a negative influence towards taxpayers' perception on tax evasion.

Tax Morale

Tax morale is often related to the inner urge to pay taxes among individuals, and it always influences tax compliance, which is under the umbrella of non-monetary motivations of tax compliance and its factors, which are outside of the standard framework. If people have the intrinsic drive, they may be more inclined to pay their taxes to the government, whereas those who lack such motivation may be more inclined to avoid paying their taxes out of laziness or guilt. They may be paying taxes against getting benefits that the



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government provides to the public. The “BEM” model has been related to tax evasion for almost forty years. In this model taxpayers, taxpayers think by themselves about how to deal with taxes, then they misrepresent the truth of the selling and buying process for services and products from tax authorities and try to minimize taxes, which ultimately brings about loss for our government and the general public too (Akram et al., 2012). The other model suggested by Hessing et al. is that very crucial touchstones that impact tax evasion are given as under tax rate, tax evasion, the opportunity of detection, and the penalty imposition, respectively, are found by tax collecting authorities. People may be unaware of the organization's performance and its social responsibility to pay taxes. Social models often influence the level of those fundamental motivations through which they pay taxes. The definition of tax morale further highlights that we can get many other profits by other factors rather than intrinsic motivations (Allingham & Sandmo, 1972).

“H₂. Tax Morale has a negative influence on taxpayers’ perception of tax evasion.”

Tax System

The constitution authorizes the federal authorities to gather taxes on income apart from agricultural income, taxes on wealth, and customs, and they try to reduce or remove sales taxes as well as responsibilities. The FBR “Federal Board of Revenues” and its secondary departments control Pakistan's overall tax system. The customers and clients generate the bulk of tax, and these sectors are vital for every country; on the contrary, they follow the process of pre-audit and assessment to improve their business. Tax directors often offer possible layouts to avoid paying taxes, and thus, it leads to noncompliance with the tax system. Moreover, this is an unacceptable practice for paying taxes. The ratio, the number of taxpayers, is increasing along with growth in their business sector, and their economic rise also improves. Tax devices are very important in Pakistan for collecting taxes. They must know about the country's economic growth and earnings. Tax devices indicate how much taxes are collected from the general public according to rules as well as regulations. However, taxpayers are not constantly willing and ready to satisfy the government's tax requirements. In Pakistan's collection, all taxes are done by the FBR “Federal Board of Revenue.” (Sandmo, 2005).

“H₃. The tax system has a negative influence on taxpayers’ perception of tax evasion.”

Compliance Cost

The meaning of tax compliance is too simple; usually, tax compliance means that taxpayers incur costs to comply with the tax law (Hessing, Kinsey, Elffers, & Weigel, 1988). Compliance cost is the amount of money required to pay taxes to the taxpayers. Compliance costs include all types of costs, such as paying taxes and obeying government laws, as well as administration and planning costs; these costs require a lot of money and time to file paperwork. The cost of compliance is like an additional sacrifice amount by the taxpayers. Then, the taxpayers think they should misrepresent the truth and minimize taxes, including tax evasion or tax avoidance. Tax compliance fees consist of three primary activities: time expenses, financial fees, as well as psychological costs to the taxpayers. Time expenses occurred by the taxpayer on maintaining the tax document for taxes, preparing tax info, and meeting with tax experts, in addition to time spent coping with the tax system. Financial fees consist of amounts paid to tax specialists (tax negotiators, marketers, and auditors) and costs regarding tax instruments information, books, statements, and different associated costs. Psychological costs include the nervousness of handling complicated tax topics. Numerous opinions, thoughts, and practical measures have been propounded to improve tax compliance and get the maximum taxes. However, tax compliance is the oldest problem in developing countries (2012).

“H₄. Compliance cost has a positive influence on taxpayers’ perception of tax evasion.”

Tax Fairness

Tax fairness concepts indicate that every country's tax systems must be fair for every individual or country. The idea raises the question of what should make the tax system fair for individuals. Many researchers agreed that tax fairness was a multidimensional concept “(e.g. (Richardson & Sawyer, 2001; Jackson & Milliron, 1986; Porcano, 1984). According to (2009) Tax fairness has five dimensions: first, general distribution; second, government exchanges, the attitude of wealthy persons to taxes; fourth, flat vs. progressive tax rates; and fifth, self-interest. Using (Andreoni, Erard, & Feinstein, 1998) The questionnaire, the collected responses from two hundred ninety-two students about tax courses, and the outcome of this survey also indicated that these dimensions existed. Another study in Hong Kong proved that the exact dimensions existed in paying taxes through fairness. Additionally, (G. M., 1988) I discovered sixty dimensions, unlike the previously discovered five. This study came up with another one, middle-income earners, as the sixth dimension.

“H₅. Tax Fairness negatively influences taxpayers’ perception of tax evasion.”

Taxpayers Perception

Taxpayers' perceptions and attitudes are constantly changing because every individual has their perception and attitude about tax evasion in mind. Primarily, researchers indicated that taxpayers could evade taxes in some situations, such as injustices in the tax systems of related countries. (G. M. , 1988), (Gilligan & Richardson, 2005) The authors discovered that unfairness in a tax system leads to tax evasion. This response was from one hundred twenty-four respondents from Hadhramout University in Yemen. Additionally, almost one hundred fourteen future leaders of Guatemala support these results. (Lambert & Thoresen, 2012) Little research has discovered that tax evasion can never be justified, taking responses from 4392 respondents in the USA, New Zealand, and Australia. "(Mcgee, Aljaaidi, & Musibah, 2012)". The researcher discovered that the tax perception level positively correlates with compliance behaviour in Malaysian countries.

Research Methodology

The research methodology that has been accomplished to conduct the research successfully. It encompasses influencing factors of tax evasion: the Tax system, Tax knowledge, Tax fairness, Tax Morale, and Tax compliance cost. This study was surveyed in major cities of Pakistan. The researcher took responses from respondents who are paying taxes to the government. The researcher selected taxpayer participants to include teachers, professors, advocates, civil society persons, doctors, shopkeepers, bankers, franchise holders, Rice mill holders, wheat mill holders, hotel owners, restaurant owners, medical stores, some wholesaler dealers, shops, and state agency holders peoples. A sample of 394 respondents participated in the study. The sampling technique for this project was convenience sampling, a non-probability sampling technique. In this study, a close-ended questionnaire was utilized. The questionnaire contains 42 items and four demographic items. The problem-related questions were measured using a 5-point Lickert Scale, with 1 representing strong disagreement, 2 representing disagreement, 3 representing neutrality, 4 representing agreement, and 5 representing strong agreement. Questionnaire details are Demographics (04 items), Tax Evasion (07 items), Tax System (07 items), Tax Morale (07 items), Tax Fairness (07 items), Tax Knowledge (07 items), and Tax Compliance cost (07 items). Using Smart PLS 3.2.9, we performed a Partial Least Squares (PLS) analysis on the study model (Ringle, et al, 2015). We first examined the structural model, as per the two-step analytic process advocated by (Anderson & Gerbing, 1988), and then tested the measurement model (Hair et al, 2014). The path coefficients and loadings were statistically examined using a bootstrapping technique (5000 resample) (Hair et al., 2014).

Discussion of the Results

Measurement Model

When evaluating a measurement model, we checked its convergent validity and then moved on to checking its discriminant validity. Examining the loadings, the average variance extracted, and the composite reliability is often used to determine whether the measurement possesses convergent validity. (Gholami et al., 2013). According to the research, all loadings were more significant than 0.5, all composite reliabilities were more outstanding than 0.7, and the AVE was more significant than 0.5. (see Table 1).

Table 1. Measurement Model

Constructs	Items	Loadings	AVE	CR
Tax Compliance	TC1	0.564	0.887	0.547
	TC2	0.832		
	TC3	0.878		
	TC4	0.866		
	TC5	0.743		
	TC6	0.883		
	TC7	0.656		
Tax Evasion	TE1	0.685	0.918	0.617
	TE2	0.818		
	TE3	0.848		
	TE4	0.858		
	TE5	0.700		
	TE6	0.734		

	TE7	0.833		
	TF1	0.838		
	TF2	0.887		
	TF3	0.766		
Tax Fairness	TF4	0.847	0.903	0.577
	TF5	0.622		
	TF6	0.557		
	TF7	0.739		
	TK1	0.821		
	TK2	0.714		
	TK3	0.603		
Tax Knowledge	TK4	0.841	0.908	0.587
	TK5	0.764		
	TK6	0.814		
	TK7	0.781		
	TM1	0.849		
	TM2	0.866		
	TM3	0.714		
Tax Morale	TM4	0.687	0.904	0.578
	TM5	0.729		
	TM6	0.588		
	TM7	0.848		
	TS1	0.877		
	TS2	0.811		
	TS3	0.788		
Tax System	TS4	0.664	0.909	0.589
	TS5	0.668		
	TS6	0.812		
	TS7	0.728		

The (Henseler et al., 2015) criterion of comparing construct correlations to the square root of the average variance recovered for that construct was used to assess items' discriminant measurement. To test the measures' discriminant validity (see Table 2). Table 4 shows the discriminant validity results utilizing this new method. We used the HTMT criterion (Henseler et al., 2015) revised to evaluate discriminant validity (Franke & Sarstedt, 2019). The harsher HTMT value is 0.85, while the mode permissive is 0.90. Table 4 shows that all HTMT values were below 0.85, indicating that respondents comprehended that the six notions are unique. Both validity tests showed that measurement items are valid and reliable.

Table 2. Discriminant Validity

Constructs	1	2	3	4	5	6
Tax Compliance	0.941					
Tax Evasion	0.136	0.958				
Tax Fairness	0.089	0.159	0.950			

Tax Knowledge	0.115	0.069	0.456	0.953		
Tax Morale	0.081	0.815	0.152	0.149	0.951	
Tax System	0.090	0.837	0.106	0.131	0.869	0.953

Structural Model

Hair et al, (2014) It is proposed to utilize a bootstrapping process with a resampling size 5000 to evaluate the structural model by looking at the R², beta, and t-values that correlate to them. The investigation results into the postulated structural model are presented in Table 3, which can be found here.

The explained variance R² has been reached, which ensures a minimum degree of explanatory power; this has been accomplished to determine whether or not the variance explained of a given endogenous concept is sufficient. The R² value was 0.645, which indicates that the independent variables of 'Tax Compliance,' 'Tax Fairness,' 'Tax Knowledge,' 'Tax Morale,' and 'Tax System' can explain 64.5 percent of the variance in the degree of 'Tax Evasion.' Overall, the model is a reasonable fit and has high predictive relevance in our data.

Table 3 presents the structural model of this study. A close look at Table 3 shows that 'Tax Compliance' was positively related ($\beta=0.107$, $p < .05$) to 'Tax Evasion', and so were 'Tax Fairness' ($\beta = -0.105$, $p < .05$) and 'Tax Knowledge' ($\beta = -0.098$, $p < .05$); whereas 'Tax Morale' ($\beta = -0.358$, $p < .01$) and 'Tax system' ($\beta = -0.482$, $p < .01$) were significant predictors of 'Tax Evasion'. Thus, H1, H2, H3 H4 and H5 were supported.

Table 3. Hypotheses Testing

Hypothesis	Relationship	Std. Beta	Std. Error	T-Value	P Values	Decision
H1	Tax Compliance -> Tax Evasion	0.107	0.048	2.225	0.013	Supported
H2	Tax Fairness -> Tax Evasion	-0.105	0.053	1.999	0.023	Supported
H3	Tax Knowledge -> Tax Evasion	-0.098	0.053	1.874	0.031	Supported
H4	Tax Morale -> Tax Evasion	-0.358	0.083	4.330	0.000	Supported
H5	Tax System -> Tax Evasion	-0.482	0.078	6.175	0.000	Supported

Conclusion

This research aims to indicate the general application of Tax Evasion and factors that influence tax evasion, like the tax system, tax morale, tax knowledge, tax fairness, and compliance cost. Mostly, the public does not like to pay taxes to the government; however, the government is necessary as a backbone because the country's government depends on taxes worldwide. In tax evasion, taxpayers misrepresent the truth about earnings earned from business activities to the tax system, causing governments to have fewer earnings than previous earnings. The researcher is collecting data about taxes and tax avoidance from well-known taxpayers. Tax avoidance is the legal use of tax policies to lower the individual's tax load. Both tax evasion and avoidance may be considered varieties of tax non-compliance. Tax non-compliance means activities genuinely unfavourable to the government tax system. In this research, the researcher has been working on factors influencing tax evasion, such as the tax system, tax morale, tax knowledge, tax fairness, and tax compliance cost. In Pakistan, taxes are collected by FBR. The government collects taxes against services like security, cleanliness, health, education, shelter homes, etc. Non-compliance is dangerous in the tax system of all countries; all countries are removing non-compliance (unfavourable activities in the tax system for taxpayers). The researcher collected data with the help of a structured questionnaire, which was filled out by 394 different taxpayers from different government departments and private jobholders of Karachi, Lahore, and Islamabad cities of Sindh, Pakistan division. In conclusion, the researcher got information about tax evasion and its factors. This study result indicated that tax compliance has a positive influence, while tax fairness, tax knowledge, tax morale, and the tax system negatively influence taxpayers' perceptions of tax evasion.

Implications for Theory

Implications for Managers:

All public and private departments should remove barriers and prioritise tax compliance factors over others. This will reduce tax evasion.

Limitations and Future Research Directions

This research is limited to Pakistan's major cities, namely Karachi, Lahore, and Islamabad, while further research extends to all cities or provinces of Pakistan to enhance the significance of the research.



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