

Article: **FACTORS AFFECTING VOLUNTARY TAX COMPLIANCE WITH A MODERATING ROLE OF TAX AWARENESS AND EDUCATION: EVIDENCE FROM IMPLEMENTED SERVICES TAX IN KHYBER PAKHTUNKHWA**

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FACTORS AFFECTING VOLUNTARY TAX COMPLIANCE WITH A MODERATING ROLE OF TAX AWARENESS AND EDUCATION: EVIDENCE FROM IMPLEMENTED SERVICES TAX IN KHYBER PAKHTUNKHWA

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ABSTRACT

This study investigates voluntary tax compliance in Khyber Pakhtunkhwa (KP), Pakistan, specifically looking at the Sales Tax on Services following the 2010 decentralization. The study investigates the impact of Tax Knowledge, on Tax Compliance with moderating role of Tax Awareness and Education by analyzing 440 KPRA-registered taxpayers with SPSS. This research aims to uncover factors that influence compliance in a location where legislation is always changing. The finding shows good insights for tax authority as well as for government the newly implemented service tax and their compliance. This research also shows the knowledge of taxpayer regarding digital tax system and their view of tax system knowledge and the potential for increase of services tax satisfaction level. Tax Knowledge show significant impact on tax compliance, and on the other hand Tax Awareness & Education also plays the moderating role. It Emphasizing the importance of tax knowledge and awareness, it proposes creative solutions to improve compliance in changing regulatory environments. The study output provides the services tax compliance in Khyber Pakhtunkhwa, it highlights the importance of tax knowledge and awareness and education in compliance. The result is valuable for tax authority in policy making and tax administration. This study emphasize the factors that are influencing tax compliance and the study also concluded the role of these factors in practical strategies for increasing tax compliance, and the contribution to the literature on tax compliance.

Keywords: Tax Knowledge, Tax Compliance, Tax Awareness and Education; Sales Tax on Services.

Background of the Study

In 2000, Pakistan introduced the Sales Tax on Services, marking a significant shift in its fiscal policy that impacted all provinces and led to the creation of local tax regulations. Initially managed by the Federal Government due to provincial limitations,¹ the landscape transformed with the 18th Constitutional Amendments in 2010, granting provinces the authority to oversee their tax affairs. This shift empowered provinces like Sindh, Punjab, and Khyber Pakhtunkhwa (KP) to formulate their own Sales Tax on Services Acts between 2011 and 2013,² and establish dedicated tax collection agencies, such as the Khyber Pakhtunkhwa

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Revenue Authority (KPRA) in 2013. These agencies not only focus on tax collection but also prioritize taxpayer education and awareness, operating on the principle that well-informed taxpayers are more likely to adhere to tax laws, thereby enhancing the tax system's efficiency and effectiveness.³ This approach echoes Richard M. Bird's analysis, which underscores the importance of understanding the multifaceted nature of taxation and the role of awareness and education,⁴ including its administrative and socio-political dimensions, to improve tax compliance, knowledge, and education. Pakistan's struggle with tax revenue generation is exacerbated by a large informal economy with the development of the economy of the country⁵, a narrow tax base, widespread tax evasion, and corruption, underscoring the need for urgent tax reforms to increase compliance rates and broaden the tax base and particular issue.⁶ This need harks back to historical shifts in tax collection responsibilities, from the provinces to the federal level, as seen in the transition from the India Act of 1935 to the Sales Tax Act of 1948, highlighting the ongoing challenges and evolution of tax administration in the country.

The history of Sales Tax may be traced back to the India Act of 1935, which assigned the General Sales Tax to provincial administration. The Sales Tax Act of 1948 transferred the collecting responsibility to the Federal Government. This decision was later overturned by the Sales Tax Act of 1957 and further broadened by a Presidential Order in 1960.⁷ Prior to 2013, the Federal Board of Revenue (FBR) was responsible for collecting sales and services taxes and then allocating the funds across provinces. Unlike income tax, service tax does not have particular exclusions or changing tax rates based on different companies or income levels. This reflects a consistent approach to taxing services rendered.⁸ Since 2013, the formation of the KPRA has led to a significant rise in services tax collection. From 2001 to 2013, FBR gathered Rs. 22.80 billion, while KPRA amassed Rs. 29.50 billion in four years.⁹ The study poses two primary questions; how do tax knowledge, tax awareness, and tax education influence voluntary tax compliance behavior among taxpayers? And, does tax awareness and education mediate the relationship between tax knowledge and voluntary tax compliance?

Gap in Research

The lack of international tax coordination and thorough information sharing emphasizes the immediate requirement for reform based on principles and a more extensive institutional strategy to tackle the intricacies of cross-border intercompany financing activities. This underscores a significant research gap in the advancement of global tax policies.¹⁰ There is a critical research gap in Ethiopia regarding the assignment of Value Added Tax (VAT) revenue, which should be re-examined by considering the tax's design, legal monetary associations, experiences from other nations that are developing, and the capacity for implementing sub-national VAT.¹¹ Studying how tax awareness and education affect identifying different groups of taxpayers, considering emotional elements, and creating specific government initiatives for these groups is a notable area without research.¹² Extending the approach used for evaluating tax compliance variables to other countries and verifying the premise that the complexity of the tax system has an impact on the costs of tax administration by adjusting the constraint in equation (17) presents a valuable direction for future research.¹³

Problem Statement

Although there has been an increase in sector registration in KP, there is still a gap in expected tax collection linked to compliance, especially in the services sector including small-scale entrepreneurs. Challenges include a notable deficiency in tax awareness and education, which is hindering compliance efforts.¹⁴ This study seeks to explore how increasing tax understanding and instruction among traders can enhance compliance. It is supported by theories and research that demonstrate the positive influence of awareness and educational initiatives on compliance rates.¹⁵ It is necessary for Pakistan to fill these education and knowledge gaps in order to ensure more consistent revenue streams and reduce its borrowing requirements, particularly important due to the services sector's significant underperformance in tax collection.¹⁶

Research Questions

1. What impact do digital platforms for tax information have on service tax compliance and taxpayer satisfaction with tax authority services?
2. How does tax awareness and education, delivered through various channels, influence the connection between tax knowledge and compliance in the services tax sector?

Objectives of the study

The primary objective of this research is to enhance Services Tax compliance by probing the interplay between tax knowledge, digital information preference, awareness, education, and taxpayer satisfaction. Specifically, it seeks to:

1. Assess the impact of digital tax knowledge platforms on taxpayer compliance and service satisfaction within the services sector.
2. Examine how tax awareness and education across different channels enhance the effect of tax knowledge on compliance, evaluating the effectiveness of current educational approaches.

The overarching goal is to collect insights that inform policy adjustments and educational enhancements, ultimately elevating compliance rates and fostering a mutually beneficial environment for taxpayers and the services tax authority.

Significance of the Study

Through the intertwining of tax knowledge with the moderating functions of tax awareness and education, the study makes a substantial contribution to the advancement of academic understanding of tax compliance. This relationship is supported by theories such as the Economic Based Theory.¹⁷ Previous studies have shown that there is a direct and positive association between tax awareness and compliance. This builds on those findings,¹⁸ deeper investigation into the ways in which education and awareness strengthen this relationship. The practical implication guides the tax department in implementation of laws and learning activities to educate taxpayer and increase awareness in order to increase services tax compliance.¹⁹

LITERATURE REVIEW

Theoretical Review

The Theory of Planned Behavior (TPB) show the concern of tax knowledge, tax awareness and education with tax compliance. This theory explain the individual's education and awareness level and impact of these on their compliance and behavior intention, the fundamental work of the behavior and intension on the individual act and compliance were carried out by Ajzen.²⁰ The theory is relevant for studying the taxpayer compliance, and the role of tax knowledge, awareness, and education in tax compliance. The relationship of tax knowledge were explain from the economics point of view and theoretical point of view.²¹ The individuals approach regarding compliance their cost and benefit analysis and advantages of compliance against the potential problems that could arise from non-compliance were also explain and the major source and remedy with the help of training and development and knowledge and awareness was completely elaborate by many researcher.²² The contributions that were made by²³the importance of tax awareness and education in the process of developing a culture that is sympathetic to compliance should be emphasized. The behavior and psychology of individual view play important role by keeping in view the individual cultural standards, ethical and attitudes views on compliance behavior is brought to the forefront and increase of taxpayer knowledge and awareness within the Theory of Planned Behavior framework effectively aligns individual motivations with societal benefits, fostering a culture of compliance attuned to societal expectations.

Empirical Literature Review

Tax compliance and collection play a very important role and the same is considerably influenced on the revenue collection. The government of Khyber Pakhtunkhwa issue material and instruction regarding taxable services and tax rate reductions, which increase in sales tax collections in every year. The increase in revenue collection play also badly affected due to less knowledge and awareness. The KPRA tax authority enhance their tax plan in every year in order to cover and improve taxpayer facilitation through different awareness campaigns have which is the key of voluntary compliance. This services tax has shift this province into another side by collection of very high volume of taxes through KPRA and now the revenue department has focus that our region's economic development and governance has the key role of services tax.²⁴

Impact of Tax knowledge on Tax Compliance

In accordance with the TPB, the tax knowledge has a significant impact on the tax compliance.²⁵According to TPB, individual taxpayer attitudes toward conduct and perceived behavior control are the factors that are most likely to predict the degree of compliance is directly proportional to the amount of awareness of taxation. These correlations are supported by research, with studies such as that in particular²⁶It is important to emphasize that higher tax awareness leads to increased compliance in terms of tax payment. According to study, this good influence is confirmed²⁷provides additional evidence that demonstrates the critical impact that tax knowledge plays in improving overall tax compliance.

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In accordance with the findings of, taxpayers' compliance behavior is significantly impacted by their level of personal tax knowledge. Taxpayers' compliance is substantially impacted by their level of understanding of the rules and their level of tax education. There is a clear correlation between the level of tax knowledge an individual possesses and the accuracy with which they submit their tax returns and fulfill their tax responsibilities.²⁸ The study conducted²⁹, underscores the significance of tax expertise in adhering to tax regulations. The text explores how political goals can impact the classification of Value Added or Consumption Tax revenue. Tax category use, as previously said,³⁰ emphasizes the importance of taxpayers possessing a thorough comprehension of tax regulations in order to navigate intricate systems.

The influence of tax knowledge on compliance is closely connected to the clarity of tax systems.³¹ It is essential to stress the importance of an easy system for filing tax returns, since research has demonstrated that simpler tax returns lead to higher levels of tax compliance. The research was conducted against the backdrop of tax compliance³², offers a deeper picture of the behavior of taxpayers. It demonstrates that a significant number of taxpayers choose to work with tax advisors that take cautious measures in order to decrease their tax responsibilities in a secure manner. The Theory of Planned Behavior indicates that enhanced tax knowledge and awareness lead to greater compliance, a relationship supported across various contexts, from individuals to SMEs.

The moderating role of Tax Awareness and Education on Tax Compliance

The study aims to check the influences between tax knowledge and taxpayer compliance with the moderating role of tax awareness and education. The literature show association between tax knowledge and compliance, despite the element that tax knowledge directly influence on tax compliance. In addition, the study reveals the significant role that tax awareness plays in the increase of taxpayer compliance behavior. The output of the study shown that a high degree of tax awareness among taxpayers can amplify the good benefits that tax knowledge has on compliance.³³

The study further shown the lack of tax awareness and education in taxpayer, which were noted by the government to relax the complexities of taxes and improve taxpayers compliance. The study shows tax awareness and education has a positive influence that tax knowledge has on taxpayer compliance.³⁴The findings of Amin et al. also show that tax knowledge and education have significant impact on the level of tax compliance among taxpayers. The understanding of Pakistan tax and law and policy also pay a vital role in the compliance. The findings of the study, tax awareness plays a crucial part in reducing instances of tax evasion and avoidance, the importance of tax awareness and education cannot be ignored in respect of the compliance practices.³⁵ The study of tax awareness and education moderate the impact of tax knowledge on tax compliance were also noted for critical view. The increased awareness and education of tax duties strengthen the relationship of tax awareness for compliance.³⁶The findings different researcher show the importance of tax awareness and education to increase tax compliance, offering a calculated method to foster a more knowledgeable taxpayer population.

Conceptual Research Framework

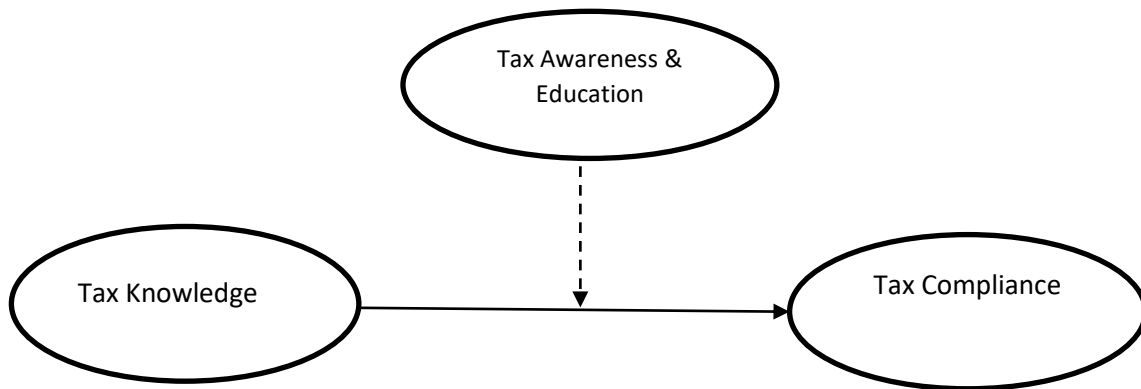


Figure 1: Conceptual Framework. Source.³⁷

Hypotheses Development

The instant research and their hypotheses regarding the relationship between Tax Knowledge and Tax Compliance,³⁸ by the Tax Awareness and Education play as moderating variables, from the findings of the above literature.³⁹

Hypothesis 1 (H1): There is a significance impact of tax knowledge on tax compliance.

Hypothesis 2 (H2): Tax awareness and education play the role of moderators between tax knowledge and tax compliance.

RESEARCH METHODOLOGY

Data collection and Research Design

The study surveyed 440 registered taxpayers in KP to quantitatively study the association between tax knowledge and compliance, using SPSS for descriptive, regression, and moderation analyses to see the effects of awareness and education. It aimed for severe ethical standards, with significant results defined by a 95% confidence interval and a p-value under 0.05.

Model Specification

The Model-1 examines the direct effect of tax knowledge on compliance, whereas Model-2 discovers that how tax awareness moderates the relationship between tax knowledge and compliance, basically present a distinct view to Model-1.

$$\text{Model 1: } Y_i = \alpha + \beta_1 X_{1i} + \epsilon_i$$

$$\text{Model 2: } Y_i = \alpha + \beta_1 X_{1i} + \beta_2 X_{1i} \cdot M_i + \epsilon_i$$

Where;

Y_i = is the dependent variable (the variable we trying to predict).

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β =Coefficient indicating rate of change of variable.

α =is the intercept term.

$X = X_1$ is the independent variable (predictors or features).

$\epsilon = \epsilon_i$ represents the error term or residual for the i-th observation.

$\beta = \beta_1$ is the coefficients connected with the independent variable X_1 correspondingly.

B_2 is the coefficient connected with the interaction terms between X_1 and the moderator variable M_i .

$M = M_i$ is the moderator variable.

This design aims to dissect tax compliance behavior by examining the direct impact of tax knowledge and the nuanced effects when moderated by factors like tax awareness.

RESULTS AND RESEARCH

The study showed a preference for self-registration for taxes and included 440 taxpayers, with 95.20% being male and 4.80% being female. The construction and hospitality industries, as well as the Peshawar region, were hit hard by this trend. In order to make the KPRA more user-friendly, respondents suggested that it simplify its tax procedures. The need of KPRA improving its tax management methods and implementing policies to increase taxpayer participation and compliance is highlighted by these findings.

Sales Tax on Service Knowledge, Awareness and Education and Tax Compliance Level

Table-4.1: Knowledge and information of Sales Tax on Services

Source of Tax Knowledge	Registration Knowledge (%)	Filing Tax Returns (%)	Registering Complaints (%)
Physically visiting the KPRA facility	16.40%	13.90%	2%
KPRA Website	25.70%	28.90%	2.30%
KPRA Facebook/Twitter	3.60%	2%	0%
KPRA YouTube Channel	0.90%	1.80%	0%
KPRA Call Centre	1.80%	1.80%	3%
KPRA broadcast SMS	3.60%	3.20%	49.50%
Electronic Media (TV, Radio, E-news)	1.60%	0.90%	49.50%
Tax Consultants (Experts)	0.90%	6.10%	0.50%

Word of Mouth (Family/Friends)	3.20%	2.30%	0.20%
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Table 4.1 indicates taxpayers' inclination towards digital platforms for tax information, with the KPRA website being the most favored option for understanding registration (25.7%) and submitting returns (28.9%). KPRA primarily uses SMS and electronic media equally (49.5% each) as the major platforms for receiving complaints, showing a trend towards digital and public communication in tax-related matters. Conventional approaches such as visiting KPRA offices or seeking advice from tax specialists are becoming less common, highlighting a shift towards utilizing internet resources for tax compliance.

Table-4.2: Select Primary Source of Tax Awareness and Education

Source of Awareness	Registration Knowledge (%)	Filing Tax Returns (%)	Registering Complaints (%)
Physically visiting the KPRA facility	26.4	6.4	2.7
KPRA Website	25.5	33	0.7
Tax Consultants	1.8	9.8	0.5
Word of Mouth (Family/Friends)	0.2	1.4	0.2
WhatsApp	0.7	0.2	2
Citizen Portal	2.3	1.1	8.6
Call	0.2	0.2	0.7
Email	-	0.2	2.5
Call and Email	-	0.2	0.9
Email and Verbal	-	0.2	0.2
KPRA Office			0.2

Among KPRA taxpayers, Table 4.2 shows that different sources of tax information are preferred by different percentages. For registration information, 26.4% prefer to visit KPRA facilities in person, while 33.0% prefer to use the KPRA website. It is evident that taxpayers prefer different routes for different jobs, as the Citizen Portal is the top choice for lodging complaints (8.6%). This emphasizes the necessity for KPRA to continue offering taxpayer education and services through a broad approach.

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Table 4.3: Rate of satisfaction Officials in dealing different activities.

Satisfaction Level	Registration (%)	Filing Tax Returns with KPRA (%)	Registering Complaints/ Grievances (%)
Not Applicable	50.5	50.5	91.4
Completely Satisfied	19.5	17.3	1.8
Satisfied	25.5	26.4	3.2
Partially Satisfied	4.1	4.3	2.5
Unsatisfied	0.5	1.6	1.1
Total	100	100	100

According to Table 4.3, a significant majority of respondents are satisfied with the tax registration and filing processes offered by KPRA (69% and 67.3%, respectively), however the number of satisfied with the complaint processing is significantly lower at 5%. The importance of KPRA enhancing its process for resolving complaints is underscored by this process.

Correlation Analysis

Table 4.4: Correlation Analysis between Tax Knowledge and Tax Compliance

	TK	TC
TK	1	.146**
TC	.146**	1

Sig. (2-tailed): TK vs. TC = .002

Note: ** indicates a statistically significant correlation at the 0.01 level (2-tailed).

Consistent with previous research, the relationship between tax compliance and tax knowledge (TC) has a correlation coefficient of 0.146 ($p = .002$). Consistent with previous findings, Adhiambo found a connection between higher tax knowledge and more compliant actions. There needs to be sustained effort to improve taxpayer education in order to see more noticeable improvements in compliance rates, as the association is statistically significant but weak in strength.

Hypothesis Testing

The hypotheses and other statistical tests were conducted in the context of the study.⁴⁰⁴¹⁴²

H₁: Tax Knowledge has a significance impact on Tax Compliance.

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.363	.132	.130	.28320

Table 4.5 summarizes the model's goodness-of-fit, showing a modest positive association between Tax Knowledge and Tax Compliance and accounting for around 13% of the variability in Tax Compliance.

Table 4.6: ANOVA

Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	5.327	1	5.327	66.422
	Residual	35.128	438	.080	
	Total	40.455	439		

The statistical significance of the regression model is demonstrated by Table 4.6 ANOVA results, which show that Tax Knowledge has a considerable impact on Tax Compliance (F-value of 66.422, $p < .001$).

Table 4.7: Coefficients

Model	Coefficient	Std. Error	Beta	t	Sig.
1	Constant: .800	.018		43.660	< .001
	TK (Tax Knowledge): .121	.015	.363	8.150	< .001

The regression coefficients, as shown in table 4.7, show that there is a positive and statistically significant association between tax knowledge and tax compliance. The idea that Tax Knowledge positively promotes compliance behaviors is supported by the fact that Tax Compliance increases by 0.121 units for every unit increase in Tax Knowledge.

H₂: Tax knowledge has significance impact on Tax Compliance with moderating role of Tax Awareness & Education.

Table 4.8: Model Summary

Variable	R	R-squared	MSE	F	df1	df2	p-value
TC	.3216	.1034	.0714	16.7647	3	436	< .0001

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Overall, the model explains roughly 10.34% of the variation in Tax Compliance, as shown in table 4.8, which highlights the model's fit. The association between the model variables and Tax Compliance is modest.

Table 4.9: Coefficients of Model Variables

Variable	Coefficient	Standard Error	t-value	p-value	Lower 95% CI	Upper 95% CI
Constant	.3251	.2972	1.0938	.2746	-.2591	.9092
TK (X)	1.2034	.2229	5.3982	< .0001	.7653	1.6416
TAE (W)	.8352	.1986	4.2056	< .0001	.4449	1.2255
TK x TAE	-.9061	.1648	-5.4995	< .0001	-1.2299	-.5823

There are substantial impacts of Tax Knowledge (TK), Tax Awareness and Education (TAE), and the interaction effect between the two on Tax Compliance (TC), as seen in table 4.9, which displays the model's coefficients.

Table 4.10: Interaction Analysis and Conditional Effects

(a) Interaction Analysis

Interaction	R-squared Change	F-value	df1	df2	p-value
TK x TAE	.0622	30.2440	1	436	< .0001

(b) Conditional Effects of TK at Values of TAE

TAE	Effect	se	t-value	p-value	Lower 95% CI	Upper 95% CI
1.3200	.0074	.0346	.2127	.8316	-.0607	.0754
1.8600	-.4819	.0929	-5.1895	< .0001	-.6645	-.2994

To illustrate the moderating effect of TAE, Table 4.10 shows the statistically significant interaction between TK and TAE in Table 3(a), and the conditional effects of TK on TC at certain TAE values in Table 3 (b).

This study emphasizes the importance of tax education, awareness, and knowledge in improving tax compliance, and it states that digital platforms are very effective in disseminating this information. The output align with the TBP, which show that taxpayers who are knowledgeable are more willing to follow the rules regulation specifically in paying their taxes to the tax authority. The importance of taxpayers being aware and educated individual more likely agreeing with payment of taxes, and the same supported the positive correlation tax knowledge and compliance.⁴³ The tax authorities list evidence-based

instructional initiatives in order to expand compliance outcomes, as tax awareness and education are key components in this regard.⁴⁴

Conclusion:

The conclusion of this research pointed out important roles of taxpayer tax knowledge, specifically in respect of awareness and education and knowledge of digital information preferences in serving compliance with the Services Tax. It discloses a significant and positive relationship between tax knowledge and tax compliance, with the moderated role play by factors tax awareness and education. The shift in the digital tax compliance, driven by the taxpayer's preference for digital platforms for accessing tax information, stresses the role of digital channels in disseminating tax-related valuable information for knowledge. This result if closely aligns with the Theory of Planned Behavior, telling that educated taxpayers over digital means and full tax education are more tending to observe tax rules regulations. However, displeasure with the KPRA's complaint handling process points to extents needful fast improvement to adoptive a commonly beneficial connection between taxpayers and the tax authority.

Suggestion:

Keeping in view the above findings, some approaches for the increasing of tax compliance are planned. Firstly, tax authorities must prioritize advancing in their information technology structure to support the rising mandate for digital tax services and information, so streamlining the tax compliance process. Moreover, there is a need for intensive energies to uplift tax awareness and include tax education into wider educational courses, training to introduce a compliance principle from a early education stage by highlighting the group and individual assistances of tax involvement. Finally, in response to extensive dissatisfaction with its current approach, KPRA must restoration its complaint handling procedures. Launching dedicated complaint resolution networks, certifying transparency in the complaint procedure, and set strong timelines for resolution might significantly boost taxpayer belief and satisfaction.

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