The Role of Financial Strain and Trust in Government in Shaping Taxpayer Compliance: A Conceptual Review

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ABSTRACT

Tax revenue is essential for national development, yet sustaining high levels of tax compliance remains challenging, particularly in regions marked by poverty and income inequality. Sabah, which has the highest poverty rate and some of the widest income disparities in Malaysia, offers a context where financial strain may strongly influence taxpayer behaviour. This conceptual paper examines how financial strain affects individual tax compliance in Sabah by drawing on Prospect Theory to explain behavioural responses under economic pressure and the Theory of Planned Behavior (TPB) to clarify how trust in government act as a mediator and mediate the relationship between financial strain and tax compliance intentions. A review of existing literature highlights a notable empirical gap regarding the effects of financial strain on tax compliance in settings characterised by socioeconomic hardship. To address this, the proposed framework incorporates trust in government as a mediating variable, recognising that institutional confidence may transmit or modify the impact of financial strain on compliance. The study contributes theoretically by integrating behavioural economics and TPB, and practically by offering insights for the Inland Revenue Board of Malaysia (IRBM) in developing more equitable and targeted compliance strategies. It further establishes a foundation for future empirical research.

Keywords: Financial Strain, Tax Compliance, Income Inequality, Poverty, Trust in Government.

INTRODUCTION

Tax revenue constitutes a critical income source for governments worldwide, underpinning public expenditure in both developed and developing economies (Benk et al., 2016). In Malaysia, for instance, tax revenue source from direct taxes constitute over half of total government revenue. To enhance the voluntary tax compliance of taxpayers and the efficiency of tax administration, a better understanding of the taxpayer's attitudes, choices and motives is pertinent (OECD, 2010; Walsh, 2012). Governments are particularly concerned with tax compliance because tax revenue is essential for funding public goods and maintaining fiscal stability (Khan et al., 2024). The active taxpayer may tend to follow the tax regulations which submit the necessary monetary resources to contribute for development and redistribution of resources collected by the tax administrator (Ghani et al., 2020).

According to Surugiu et al. (2025), tax compliance refers to the extent to which taxpayers fully meet all tax obligations as required by law. It is known as a process and procedure which to convince the taxpayers to comply with the relevant tax legislations (Oladipo et al., 2022). In Malaysia, the Inland Revenue Board of Malaysia (IRBM) serves as the government's agent in assessing, collecting, administering, and enforcing direct taxes. These include income tax, real property gains tax, estate duty, petroleum tax, stamp duties, and other taxes mutually agreed upon between the government and the Board.

In the recently announced 2025 Budget, the Malaysian government introduced plans to reduce subsidies for the top 15 percent of income earners (T15), also referred to as the ultra-rich group (StashAway, 2024). The removal of benefits includes subsidies for education, healthcare, and petrol, while assistance for the B40 and M40 groups will be maintained. Specifically, the government intends to reallocate 40 percent of the RM8 billion in petrol RON95 subsidies, which previously benefited foreign nationals and the wealthiest households,

towards the improvement of public goods such as public transportation, education, and healthcare (StashAway, 2024). Although this redistribution reflects the principle of "taxing the rich to help the poor," empirical evidence indicates that such measures do not necessarily enhance citizens' financial satisfaction. Chan et al. (2020) demonstrate that policies designed to reduce inequality through taxing the wealthy and subsidising the less privileged may not directly increase perceived financial well-being, as income level and overall financial security remain stronger determinants. This observation is particularly relevant for states such as Kelantan, Sarawak, and Sabah, where average household incomes remain below the national average (The World Bank, 2024). Furthermore, in 2022, the absolute poverty rates in Sabah and Sarawak were 3.0 and 1.7 times higher than the national poverty rate, respectively (The World Bank, 2024). Persistent poverty, low household income, and income inequality are therefore likely to remain key sources of financial strain and dissatisfaction, even under redistributive policies. Prior research further suggests that financial dissatisfaction arising from economic strain is positively correlated with the likelihood of engaging in tax fraud (Stack & Kposowa, 2006).

Such above scenario may relate to financial strain, which can be linked to noncompliant tax behavior. Past research indicates that individuals experiencing economic pressure or dissatisfaction are more prone to justifying or engaging in tax fraud as a coping mechanism (Stack & Kposowa, 2006). While Malaysia's overall poverty rate has declined to 6.4%, income inequality remains high by international comparison (OECD, 2024). Sabah exemplifies this, recording the nation's highest poverty rate (19.7%) and severe income disparities, as reflected in its Gini coefficient and the wide gap between mean and median household income (OECD, 2024). These conditions create a context where financial strain may critically influence compliance decisions.

Trust in government has been selected as the mediating variable in this study because it significantly shapes how taxpayers respond to economic conditions and ultimately influences their tax compliance. Prior research shows that taxpayers' behaviour is strongly affected by their confidence in government institutions; those who trust the government are more likely to support its policies and comply voluntarily (Kirchler & Wahl, 2010; Rudolph, 2009).

Evidence from Malaysia indicates that overall trust in government is relatively low. National surveys by Ipsos (2020) reveal that more than half of respondents express low trust in both the government and the media, and politicians are consistently ranked among the least trusted professions. However, trust in enforcement bodies remains comparatively stronger: according to the Global Corruption Barometer Asia 2020, 67 percent of Malaysian respondents believe the MACC performs well in combating corruption, and 68 percent feel that ordinary citizens can contribute to anti-corruption efforts (Transparency International Malaysia, 2020). These mixed perceptions suggest that Malaysians differentiate between political leadership and public service delivery, and that varying levels of trust may meaningfully influence taxpayers' willingness to comply. Given this complexity, trust in government is incorporated as a mediator in this study to capture how citizens' institutional perceptions interact with financial strain to shape tax compliance behaviour.

Nevertheless, the specific influence of financial strain on taxpayer behaviour in high-disparity, high-poverty settings such as Sabah remains empirically underexamined. This study therefore addresses an important gap in the literature by investigating how financial strain affects tax compliance within a region characterised by substantial socioeconomic disadvantage. In addition, the study incorporates trust in government as a mediating variable to determine whether the effect of financial strain on compliance operates directly or is transmitted through taxpayers' institutional perceptions. By clarifying this relationship, the research aims to resolve existing ambiguities (Ratan et al., 2019) and determine whether financial strain together with variations in trust in government exerts a significant effect on tax compliance behavior in Sabah, Malaysia.

THEORETICAL REVIEW

Prospect Theory

Prospect Theory (PT) serves as a descriptive alternative to Expected Utility Theory (EUT) in explaining decision-making under conditions of risk. PT are developed by Kahneman and Tversky (1979), it posits that individuals do not always base their decisions on the maximization of expected utility. Instead, decisions are made by evaluating potential outcomes as gains or losses relative to a subjective reference point, rather than in

terms of absolute final wealth (Pan, 2019). One of the key effects drive the behaviour is loss aversion where losses are perceived more intensely than equivalent gains (King & Sheffrin, 2002; Tversky & Kahneman, 1981). Another key effect drive behaviour with this theory is diminishing sensitivity, where small changes near one's income level matter more than changes at higher income levels (King & Sheffrin, 2002).

In the context of tax compliance, this means taxpayers often perceive tax payments as painful losses, especially when facing financial strain, while rebates or reliefs are seen as meaningful gains. For lower-income groups, even small amounts of tax create greater sensitivity and may heighten resistance or risk-taking behavior, such as underreporting. How tax obligations are framed also matters: when seen as a loss, individuals under financial pressure may be less compliant, whereas framing taxes as contributions to public benefits may increase acceptance (Muehlbacher, 2021).

PT has been widely applied as a theoretical framework in various fields such as consumption and saving behavior (Kőszegi & Rabin, 2009), trading strategies and market quality (Pasquariello, 2014), poverty and welfare measurement (Jäntti et al., 2014), political decision making (Mercer, 2005), and tourism decision making (Lin et al., 2024). Beyond these areas, PT has also been applied in tax related studies. According to Kanbur et al. (2004), when taxpayers face income uncertainty, their behavior may be influenced by PT, particularly through loss aversion and risk seeking tendencies. Financial condition and risk preference are key factors shaping tax compliance (Anuar Syahdan et al., 2022). Bloomquist (2003) finds that taxpayers with sufficient income but poor financial condition, where expenditures exceed income, are more likely to evade taxes. Conversely, Anuar Syahdan et al. (2022) empirically demonstrate that stronger financial conditions and certain risk preferences are positively associated with higher compliance. These findings may appear contradictory but are, in fact, complementary: poor financial condition tends to decrease compliance, while better financial condition tends to enhance it. For low-income earners, strong loss aversion may sometimes offset the government's own risk aversion. When individuals perceive tax payment as a sure loss, they may strive to maintain their pre-tax position, thereby engaging in risk taking behavior such as evasion (Hlouskova & Tsigaris, 2012).

Theory of Planned Behaviour

The Theory of Planned Behavior (TPB), introduced by Ajzen (1991), extends the Theory of Reasoned Action by adding perceived behavioral control. TPB proposes that behavior is driven by behavioral intention, which is shaped by three key factors: attitude toward the behavior, subjective norms, and perceived behavioral control. Each factor is influenced by specific beliefs. Behavioral beliefs concern expected outcomes and shape attitudes. Normative beliefs reflect perceived social expectations. Control beliefs relate to an individual's perception of their ability to perform the behavior (Ajzen, 2006; Etheridge et al., 2023). Favorable attitudes, supportive social norms, and a strong sense of control generally strengthen behavioral intention.

TPB has been widely used to explain tax compliance behavior (Adhikara et al., 2022; Bobek et al., 2007; Wahyuni et al., 2023; Zikrulloh, 2024). Bobek and Hatfield (2003) concluded that the beliefs shaping attitudes, subjective norms, perceived behavioral control, and moral obligations demonstrate that the TPB is a proper framework to be applied in explaining tax compliance. This research applies TPB to explore the mediating role of trust in government in the link between financial strain and tax compliance behavior.

TPB has been used extensively in various fields, including dietary behavior (Sparks et al., 1995); speeding (Conner et al., 2007); adolescent smoking (Guo et al., 2006); and misuse of alcohol (Marcoux & Shope, 1997). Its application in tax research has also expanded. For example, Taing and Chang (2021) has examined tax compliance intention in Cambodia using TPB components. Although the determinants were not statistically significant, the study confirmed TPB's relevance in both developed and developing contexts. In Malaysia, numerous studies have applied TPB to identify determinants of tax compliance intention and behavior (Mohamad et al., 2023; Mohdali & Pope, 2014; Nik Soh et al., 2025; Radzi & Ariffin, 2022; Shaharuddin et al., 2023).

Tax Compliance

Tax compliance is behavior of the taxpayers who adheres with the tax laws and regulations of the country. The act of appropriate in reporting of income or tax base includes compute the tax liability accurately, filing returns and make payment in timely manner (Tilahun, 2019). According to Kirchler (2007), the tax compliance may be separate into two types which are voluntary and enforced tax compliance. Voluntary compliance depends on trust in tax authorities and reflects taxpayers' willingness to fulfil their obligations. When trust is low, cooperation decreases and authorities rely more on enforcement measures such as fines and audits to encourage compliance (Alm, 1991; Jackson & Milliron, 2002).

Tax compliance has been defined also been defined as the extent to which taxpayers obey tax rules and legislation by accurately reporting their liabilities, filing the required returns, and making timely payments (Youde & Lim, 2019). According to Adeyeye (2013), tax compliance refers to the ability of both taxpayers and tax authorities to ensure that taxation rules and legislation are appropriately applied so that taxes are paid accurately. Kuokštis (2017) further emphasizes that tax compliance reflects the degree to which taxpayers follow tax laws, highlighting its practical importance.

In this study, tax compliance has been selected as the response variable. The efficiency in tax collection and the tax compliance behaviour from the taxpayers are crucial for sustain the future infrastructure development and the economy growth of a country. Therefore, whether its voluntary or enforced tax compliance, it's both important in terms of tax collections in order to ensure the federal revenue increase. To understand the relationship between the independent variable and dependent variable, the current study proposes a comprehensive framework to determine their influences towards tax compliance, as demonstrated in Figure 1.

The Role of Financial Strain

The meaning of financial strain also similar with financial/economic stress, financial/economic hardship, financial distress, financial difficulties or the incapable to satisfy financial needs (French & Vigne, 2019). Economic hardship which are an individual unable to maintain an income status or living standard that satisfy their expectation. If under the policy socio-background, economic hardship is definite as insufficient income in satisfy basic living standard and necessities (Werneke, 1979). In the context of taxation, financial strain represents personal financial pressure that affects saving, spending, and compliance behaviour.

The financial condition of an individual plays a critical role in shaping their attitudes toward tax compliance. Financial dissatisfaction may generate distress, particularly when tax payments are due, as discrepancies often exist between one's actual financial situation and the aspired standard of living. In such contexts, taxes may be perceived as a significant restriction, leading to tax dishonesty (Torgler, 2007). This suggests that financial strain reduces individuals' capacity to comply with obligations, including tax submissions. In these circumstances, basic needs are typically prioritized over tax responsibilities (Mohani Abdul, 2001). Moreover, financial strain has been identified as a major source of taxpayer stress (Bloomquist, 2003). Dissatisfaction arising from lack of financial resources may also motivate individuals to engage in dishonest or criminal behaviour as they search for opportunities to cope with economic pressure (Carroll, 1986). Evidence from countries facing financial instability, such as during Lebanon's economic crisis, demonstrates that economic pressure, lack of resources, and low institutional trust can significantly reduce compliance (Islam et al., 2022). Higher trust in government is associated with better economic conditions and higher compliance, but the gap between high-trust and low-trust taxpayers widens during periods of financial strain (Kuokštis, 2017).

In regions characterised by poverty and income inequality, such as Sabah, financial strain is particularly relevant. Sabah has one of the highest poverty rates and a large B40 population, making financial pressure widespread. To ease this burden, the IRBM and government agencies have introduced assistance schemes such as *Bantuan Keluarga Malaysia* (BKM), now renamed as *Sumbangan Tunai Rahmah* (STR) (IRBM, 2025). In 2023, STR has allocated approximately RM77.7 billion to support the low-income households in Sabah. Sabah recorded one of the highest numbers of applicants, showing the extent of financial need among its households (IRBM, 2025). IRBM collaborates with multiple agencies in managing and sharing B40-related data to support government programs, including *Sumbangan Asas Rahmah* (SARA), *MySalam*, the Malaysian Indian

Transformation Unit (MITRA), the Road Transport Department (RTD), the Ministry of Health (MOH), the Ministry of Education (MOE), *Lembaga Tabung Haji*, the Ministry of Communications and Digital (MCD), the Public Service Department (PSD), and the Department of Statistics Malaysia (DOSM) (IRBM, 2025). The collaboration with agencies may coordinate assistance and support low-income groups efficient and effectively.

Despite these assistance schemes, low-income earners may continue to experience financial distress, as government aid is often insufficient to cover all household expenditures. Engida & Baisa (2014) also highlight that individuals facing such strain tend to prioritize immediate necessities and urgent financial commitments, such as debt repayments, particularly when threatened by enforcement actions from lenders. Consequently, financial hardship may encourage taxpayers to evade rather than fulfill their tax obligations. Similarly, prior studies have found that individuals under greater financial strain are more likely to evade taxes compared to those experiencing lower levels of strain (Mohani Abdul, 2001).

Overall, the literature indicates that financial strain may potentially exerts a direct and significant influence on tax compliance behavior. This makes financial strain a meaningful factor that may influence tax compliance behaviour in Sabah. The literature therefore suggests that financial pressure can lower compliance by limiting the capacity to pay taxes, increasing stress, and shifting behaviour toward short-term survival needs.

Trust in Government

Trust in government can be understood as citizens' enduring confidence that the state will function and make decisions in line with their expectations. It reflects the belief that political representatives and institutions are responsive and will act in the public's best interests, even without constant oversight (Hitlin & Shutava, 2022). It has also been described as the willingness of citizens to accept the immediate or potential ideological costs associated with complying with government actions (Tomankova, 2019).

Beyond its definitional scope, trust in government has been widely studied as a mediating factor in other perspective, such as political science and public policy research. Prior studies have examined its role in shaping the relationship between well-being and incumbent voting (Ng et al., 2022); governance quality and subjective well-being (Ma et al., 2024); COVID-19 case numbers and electoral outcomes in Korea (Yu et al., 2022); media use and different modes of participation (Miao et al., 2024); as well as perceived quality of government support and mental well-being (Poma et al., 2023).

Contrarily, within tax compliance research, trust in government emerges as a critical determinant of voluntary compliance, serving to reduce evasion and strengthen taxpayers' willingness to contribute (Damayanti et al., 2015; Kastlunger et al., 2013; Kogler et al., 2015). Nevertheless, empirical findings are not entirely consistent. For example, Taing & Chang (2021) reported no significant correlation between trust in government and tax compliance, a result that aligns with Mensah et al. (2021), who similarly found that trust in government does not significantly influence taxpayers' compliance decisions.

Evidence from developing countries such as Nigeria and Kenya shows that weak governance, corruption, and poor transparency in managing tax revenues strongly undermine tax morale (Sebele-Mpofu, 2020). When citizens doubt that tax funds will be used responsibly, trust declines and compliance drops (Sebele-Mpofu, 2020). In contexts where the rule of law is weak and officials misuse power, trust continues to erode (Ziller & Schübel, 2015). Such erosion of trust undermines government legitimacy, increases resistance to taxation, and forces states to rely on costly enforcement mechanisms to secure revenue (Sebele-Mpofu, 2020).

CONCEPTUAL MODEL DEVELOPMENT

Financial Strain and Tax Compliance

IRBM has facilitated several assistance schemes and cooperated with other agencies to provide aid for low-income households (IRBM, 2025). Under the 13th Malaysia Plan, social protection and cash transfers have been expanded through programmes such as *Sumbangan Tunai Rahmah* (STR), alongside the continued

distribution of *Sumbangan Asas Rahmah* (SARA), particularly focused on food products at affordable prices. In addition, the *RAHMAH MADANI* Sales Program will be extended to more rural areas and targeted communities to safeguard the consumption needs of the B40 group. These initiatives aim to reduce the financial burden of vulnerable groups and indirectly improve tax compliance by easing economic hardship.

From the perspective of Prospect Theory, taxpayers experiencing financial strain are more sensitive to losses and are likely to view tax payments as additional financial burdens. Loss aversion explains why individuals in difficult financial situations may perceive taxes as disproportionately painful compared to potential gains. Empirical findings support this behavioural response. Empirical evidence by Ras et al. (2024) shows that individuals under financial constraints are more likely to engage in non-compliant behaviors, such as overclaiming tax reliefs, in order to reduce their tax liabilities.

Income inequality, poverty, and low household income are major drivers of financial strain and are consistently linked to lower tax compliance. Studies have shown positive associations between inequality and tax underreporting (Bloomquist, 2003) and between poverty and evasion, as seen in regions with higher poverty (Kirchler, 2007). Similarly, Brosio et al. (2002) argued that high noncompliance can be interpreted as taxpayers' dissatisfaction with the low level of public goods provided. In the study on U.S. taxpayers, reported that the ratio of underreported tax to true tax was highest among lower-income groups (Johns & Slemrod, 2010). Previous literature also indicates that individuals in adverse financial conditions tend to prioritize the repayment of personal debts over fulfilling tax obligations (Alabede, 2012; Mekonen, 2015).

Overall, the literature supports the view that financial strain reduces taxpayers' ability and willingness to comply with tax requirements. Increased financial strain has a negative and significant effect on tax compliance because it intensifies perceived losses, may cause distress leads to the shifts of behaviour toward short-term survival rather than civic obligations.

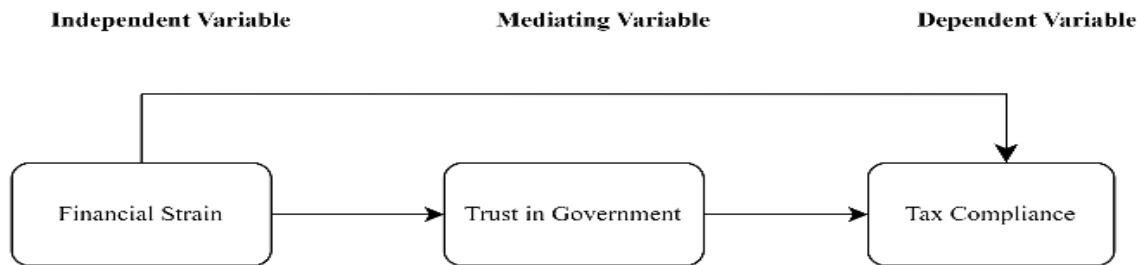## Trust in Government as Mediator of Financial Strain on Tax Compliance

Financial strain, often triggered by persistent inequality and limited social mobility, can reduce citizens' trust in government. When individuals feel that income gaps are widening and opportunities for advancement are limited, they may believe the government is not doing enough to address inequality. This weakens their willingness to fulfil fiscal responsibilities (Castañeda, 2024). Prior scholars argue that taxation operates as a form of reciprocity contract between government and citizens, where compliance depends on perceptions of government performance in providing public goods and reducing inequality (Carrillo et al., 2021; Ortega et al., 2016; Torgler, 2004). When financial pressure intensifies, individuals may perceive government support as insufficient, which further reduces trust and increases the likelihood of non-compliance.

Beyond fiscal obligations, financial strain also affects civic participation and broader perceptions of political legitimacy. As inequality deepens, disadvantaged groups are more likely to feel powerless, undermining their trust in government institutions (Uslaner & Brown, 2005). Empirical findings confirm that inequality is among the strongest determinants of declining trust, as citizens no longer perceive themselves as sharing a common fate with other social groups. This erosion of trust directly influences tax compliance behavior. According to Birskyte (2014), taxpayers are more likely to comply when they believe the government "does the right thing" and avoids wasting public resources. Conversely, when citizens perceive that the government fails to represent their interests, their trust erodes, reducing their willingness to comply accurately and on time. Thus, financial strain undermines compliance not directly but through its impact on trust in government, which serves as the critical mediator linking citizens' economic hardship to their tax behavior.

Within the TPB framework, trust in government aligns closely with the component of attitudes toward the behaviour. When trust is high, taxpayers hold more positive attitudes toward paying taxes and are more willing to comply voluntarily. When financial strain reduces trust, attitudes become negative, lowering compliance intentions. Trust may also influence subjective norms, because citizens look to government performance when evaluating whether tax compliance is socially expected. Finally, trust indirectly affects perceived behavioural control, as individuals who distrust institutions may feel less confident that their contributions lead to meaningful outcomes.

Therefore, integrating TPB strengthens the argument that trust in government mediates the relationship between financial strain and tax compliance by shaping attitudes, norms, and perceptions that guide taxpayer behaviour. Based on the above discussion, the following conceptual framework is proposed.

Figure 1: Proposed Conceptual Framework

DISCUSSION

The future research development could conduct empirical text on the proposed relationships through the usage of quantitative analysis. In particularly, testing the constructs and the hypotheses has been emphasized above. The subsequent studies may also explore on the moderating variables such as governance quality, perceived fairness or the accessibility to the government supports programs. Comparative studies across different states within Malaysia or income groups could provide cross-cultural or cross-regional validation of the model.

The empirical outcome may offer critical insights for the Inland Revenue Board of Malaysia (IRBM) in designing more equitable, targeted compliance strategies that reflect both taxpayers' financial capacity and trust in public institutions. Although the research focus on Sabah, the conceptual insights developed here may extend to regions facing similar economic pressures, contributing to broader policy development and enhanced tax administration.

CONCLUSION

This conceptual model provides an initial pathway for understanding how financial strain shapes tax compliance in Sabah, with trust in government positioned as a key mediating mechanism. As the next step, broader engagement with the literature will be essential to refine the model and guide the empirical phase of the study. Although conceptual in nature, the framework presented here contributes to existing scholarship and offers a structured basis for future empirical validation.

By integrating financial strain and trust in government, the model establishes a more comprehensive explanation of taxpayers' compliance behaviour. Theoretically, this study combines Prospect Theory and the Theory of Planned Behavior to address gaps in earlier research, particularly the limited attention given to how economic hardship interacts with institutional trust to influence compliance decisions. The inclusion of trust in government as a mediator provides a testable mechanism to examine whether financial strain affects compliance directly or indirectly through changes in taxpayers' institutional perceptions.

DELIMITATIONS AND LIMITATIONS

This conceptual paper is delimited by the scope of literature reviewed, which primarily draws from selected disciplines related to taxation and behavioural studies. As a result, the theoretical discussion may not fully incorporate perspectives from other fields that could further enhance the understanding of financial strain, trust in government and tax compliance. The study also focuses specifically on individual taxpayers in Sabah; therefore, the geographical and demographic boundaries limit the generalisability of the conceptual assumptions to other populations.

Several limitations must also be acknowledged. As a conceptual work, the discussion relies entirely on existing studies, and no empirical data have been collected at this stage to validate the proposed relationships. These

limitations indicate that the proposed framework will require refinement and empirical testing to strengthen its applicability, accuracy, and explanatory power.

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