

## Investigating the Relationship between Mental Accounting of Income Tax and VAT with Tax Compliance<sup>1</sup>

Mansour Mehrabiyan<sup>2</sup>, Ahmad Khodamipour<sup>3</sup>, Omid Pourheydari<sup>4</sup>

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Research Paper

### INTRODUCTION

One of the most important topics in the tax field is the behavioral and individual discussion of the taxpayer. Behavioral science is one of the applied sciences that entered the field of science in the form of a specialized field called psychology. The basic foundation of this knowledge is man and his inherent, behavioral and personality complexities that require understanding and recognition. Behavioral finance is a branch of behavioral science that examines financial issues from a wider social scientific point of view, including paying attention to psychology and sociology, as well as removing rational and logical frameworks. In behavioral finance, behavioral characteristics that are effective in people's decision-making process are studied. These characteristics are called behavioral tendencies (Falahpour and Abdullahi, 2011, p.102).

One of the behavioral trends is mental accounting. The phenomenon of mental accounting refers to the mental process of evaluating financial transactions. Mental accounting means that people tend to make decisions

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2. Ph.D. Student, Department of Accounting, Kerman Branch, Islamic Azad University, Kerman, Iran.  
(Corresponding Author). (mehrabm89@yahoo.com).

3. Professor, Department of Accounting, Faculty of Manegment and Economics, Shahid Bahonar University of Kerman, Kerman, Iran, (khodamipour@uk.ac.ir).

4. Professor, Department of Accounting, Faculty of Manegment and Economics, Shahid Bahonar University of Kerman, Kerman, Iran. (opourheidari@uk.ac.ir).

about different financial issues in separate mental accounts, without considering the logical assumption that it is better to make all these decisions in a portfolio. Mental accounting provides a framework so that decision-makers can prepare a set of reference points for each account and determine its profit and loss, and then using choice theory, observe the difference between types of accounts and finally make a decision (Greenblatt and Hahn, 2005, p.311).

In this research, the role of mental accounting in decisions and tax compliance is investigated. By knowing and understanding the emotional and psychological factors that are effective in the decision-making of taxpayers, it is possible to help increase tax compliance and increase tax revenue with training and techniques and even by amending tax laws regulations, and processes. Since in the previous research, most of the economic factors affecting tax compliance were examined and less attention was paid to the psychological factors affecting it, this research can lead to the expansion of knowledge in the tax field. Therefore, the current research seeks to answer this question, to what extent the mental accounting of taxpayers can be effective in their tax compliance? Therefore, the purpose of this research is to investigate the differences between taxpayers in the use of mental accounting and the effect of these differences on their tax compliance.

## **MATERIALS AND METHODS**

From the perspective of the result of its implementation, this research is of the applied type, from the perspective of the implementation process, it is part of quantitative research, and from the perspective of the purpose of the implementation, it is descriptive and survey. The purpose of applied research is to develop applied knowledge in a specific field. From the point of view of the time dimension, this research is a cross-sectional type of research in the year 2021. The tool used in this type of research is a questionnaire. This questionnaire has 33 questions based on a five-part Likert scale, which includes 25 questions regarding the mental accounting component and 8 questions regarding tax compliance. The statistical population of this research consists of financial managers, accountants, and taxpayers of businesses and companies that are required to submit tax returns in Kerman province. Considering that the statistical population of

this research is assumed to be unlimited, to determine the sample size, Cochran's formula was used for the unlimited population and the sample size was estimated to be 384 people. 500 questionnaires were distributed in person and electronically among taxpayers, financial managers, and accountants, and finally, 392 questionnaires were received completely and correctly.

**RESULTS AND DISCUSSION**

Table (1) shows the descriptive statistics of the studied variables, including mean, standard deviation, maximum, minimum, Skewness, and Kurtosis.

*Table 1. Descriptive statistics*

Variable	Number of observations	Average	standard deviation	maximum	minimum	Skewness	Kurtosis
Mental accounting	392	3/2811	0/15195	3/76	2/68	-0/314	0/474
tax compliance	392	3/1754	0/16488	3/50	2/63	-0/363	0/111

The first hypothesis of the research is presented as follows:

- 1- Tax accountants do mental accounting of income tax and value-added tax.

One-sample t-test was used to test the first hypothesis of the research. If the average score of the data is higher than the average (number 3), it means that people are doing mental accounting. Table number (2) shows the summary of the test results.

*Table 2. The results of the one-sample t-test to investigate mental accounting*

Variable	t statistic	Degrees of freedom	Significance level	Observed average
Tax compliance	392	3/1754	0/16488	3/50

As can be seen, the significance level (sig) is less than 5% and the sign of the t statistic is positive, which indicates that the scores given by the subjective accounting of income tax and added value of the respondents

are higher than the average. Therefore, according to the obtained results, it can be stated that taxpayers perform mental accounting of income tax and value-added tax, so according to the above explanations, the first hypothesis of the research is confirmed.

Second hypothesis: There is a significant relationship between mental accounting and tax compliance.

To measure tax compliance, a questionnaire with 8 questions in the form of a five-point Likert scale was provided to taxpayers, tax managers, and accountants. After completing the questionnaire, the data related to the mental accounting variable questions were transformed into one value for each respondent using the average.

To investigate the relationship between mental accounting and tax compliance, linear regression was used. The summary of the results of the second hypothesis test is described in the table below:

**Table 3. The results of the second hypothesis test**

Variable	Coefficient	t statistic	Significance level
Fixed coefficient	0/149	1/566	
Mental accounting	0/922	31/877	0/000
Statistical significance level (F) 0.000		R2=0/723	R2(adj)=0/722

Fisher's statistic was used to determine the significance of the regression model. According to Table (3), the probability value of this statistic is less than the significance level of (5) percent, so the assumption of non-linearity of the model is rejected, and as a result, it can be said that the regression model of this hypothesis is meaningful and this model can be used.

According to table (3), the significance level calculated for tax compliance (dependent variable) is less than 5%, so the null hypothesis is rejected with 95% confidence. Considering the positiveness of the mental accounting coefficient (independent variable), it can be concluded that mental accounting has a positive and significant effect on tax compliance. In other words, according to the perspective theory and the role of mental

accounting in determining the reference point in decision-making, it can be said that people who do more mental accounting have higher tax compliance than taxpayers who do less mental accounting. Therefore, according to the above explanations, the second assumption is accepted.

## **CONCLUSION**

In this research, the rate of using mental accounting was investigated using a questionnaire and a Likert scale, and according to the high scores of mental accounting, it was determined that people do mental accounting. Therefore, the first hypothesis of the research was confirmed, which is consistent with the results of Muehlbacher and Kirchler (2013). The second hypothesis of this research is to examine the relationship between mental accounting and tax compliance. Compliance is the concept of taxpayers' adherence to tax obligations and compliance with tax laws on their part. In this research, tax compliance was investigated through a questionnaire and self-report. The results of the second hypothesis showed that there is a direct relationship between mental accounting and tax compliance, and this relationship can be explained by perspective theory. According to this theory, it is assumed that the consequences of the decision are evaluated according to a reference point, which divides the value function into two areas profit and loss. The reference point may be the asset position, an expectation, or an external stimulus provided by the decision framework, and which outcome is considered a loss is a subjective matter. The results of this hypothesis are consistent with the results of the research of Olsen et al. (2019) and Muehlbacher et al.

The current research, like other research, faces limitations. For example, respondents may not answer completely honestly due to fatigue, lack of concentration, or avoidance of honest answers due to social consequences. According to the research results, the following practical suggestions are provided:

Educating taxpayers about correct mental accounting strategies seems to be an effective method for tax compliance. Such training can be done using brochures, training courses, or through friendly and supportive communication with the tax. Another way to facilitate positive mental

accounting practices is to give taxpayers the option to pay a fixed portion of their income immediately as a voluntary prepayment to the tax office.

**Keywords:** Income Tax, Mental Accounting, Tax Compliance, Value Added Tax.

**JEL Classification:** M41, H26

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