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FAIRNESS PERCEPTION AND FILING COMPLIANCE AMONG INDIVIDUAL TAXPAYERS: CONCEPTUAL PAPER

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Abstract

Taxation is major source of state revenue around the world. Most of income tax systems rely on voluntary tax compliance. However, taxation compliance is the crucial challenger that most of developing countries, including Pakistan, are facing. In Pakistan, taxation system is facing major hurdles to compliance in the form of trust deficit in the nexus of citizens and tax authorities. On the basis of extant literature including empirical, experimental and review, this study has found contextual factors influencing taxation compliance through developing fairness perception among individuals. Contextual factors including tax utilization disclosure, taxpayers' preference elicitation, facilitation and perceived tax outcomes have emerged in experimental and review studies but not empirically tested yet. Thus, this study has proposed a conceptual framework, needed to be empirically tested, with the implication of fairness heuristic theory. This manuscript will help government, especially tax authorities to devise their tax policies and tax administration accordingly to flourish tax culture through building trustworthiness among citizens.

Keywords

Tax Compliance, Perceived tax fairness, Individual Taxpayers

Introduction

Taxation compliance has been a major policy issue for all governments especially that of developing countries (Litina & Palivos, 2016). Individual income tax is one of major source of taxation revenue. In case of individuals, taxation system over the globe is based on voluntary compliance by citizens (Jimenez & Iyer, 2016). Thus the tax departments, policy makers, practitioners and academicians are working for reforms that may help to improve voluntary compliance among individual taxpayers (e Hassan et al., 2021).

Enforcement model (Alm et al., 2016; Kirchler et al., 2008a), the traditional economic model, has been used over the years by states to improve tax compliance. This model assumed individuals as rational animal, thus also named as economic decision making model (Ng & Tseng, 2008). However Simon (1955) challenged this school of thought by arguing that rationality is effected by available information, cognitive capacity and time available for decision making (Simon, 1955). So to incorporate these factors, error term was added to the conventional economic models, considering that decisions made by individuals are not always optimal. This neoclassical theory was further challenged by Tversky and Kahneman (1974). They argued that predictability of errors helps to predict deviations from rational choices. So they suggested to incorporate the psychological elements into the conventional economic models to understand

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CJSSR
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decision making among individuals (Tversky & Kahneman, 1974). Based on these contributions, number of studies have come up with the suggestion that there is need of tax reforms that incentivize tax compliance among individuals, instead of relying on enforcement paradigm that is based on commands, audits and penalties. Furthermore, A group of experimental research have tested psychological elements and heuristics and suggested that devising tax policies, with the incorporation of socio-psychological elements, will help to improve compliance among individuals. Moreover, around 200 states have created and introduced the idea of nudging that can lead individuals' decisions towards collective welfare of society (OECD, 2017).

Prevalent studies from literature have analyzed some socio-psychological factors that are found to be affecting filing compliance among public. Most important factors include perception about fairness (Bordignon, 1993), trust level on tax authorities (Litina & Palivos, 2016), societal values and norms (Bobek et al., 2013), cultural specifications (Ariyanto et al., 2020), and personal values (Vehovar et al., 2018). Few concepts such as tax utilization disclosure, taxpayers' preference elicitation, facilitation and convenience and perceived tax outcomes have emerged in empirical and review studies but have limited empirical evidence. Providing information to taxpayer, involving them to tax decisions and providing effective taxation system are approved to be significant factor to manipulate individuals' perception about fair taxation, thus leading towards boosting filing compliance (Abbiati et al., 2020).

Literature Review

Recent economic downturns and budget are instigating tax authorities to fetch the ways to enhance voluntary taxation compliance among citizens (Batrancea et al., 2019; Kirchler et al., 2008b). Tax compliance is considered as the citizens' readiness to pay taxes and act accordingly, either voluntarily or forcefully. Rather tax noncompliance means the citizen did not fulfill taxation responsibilities (Bobek et al., 2013). James & Alley (2002) suggested that tax compliance is not only the compliance with taxation laws, but also a commitment to state' objectives and societal well-being (James & Alley, 2002).

Among societal and personal factors, Fairness perception of citizens about taxation is found to be very influencing factor nudging their compliance decisions. However, this perception is developed on the basis of contextual factors (Alm & Torgler, 2011a). Thus citizens are inclined to act in accordance with state laws, if they found authorities trustworthy (Alm & Torgler, 2011a; Drogalas et al., 2018).

This study has implied Fairness Heuristic Theory (Lind, 2001), along Social Exchange Theory (Cook & Rice, 2006). Fairness Heuristic Theory argues that participants do not always have direct and relevant information about a particular phenomenon to make fairness judgments and decision. So, people process contextual information heuristically to make fairness judgment about a certain phenomenon. Thus, this theory put forward a more contextual explanation of the justice perception instead of direct and relevant information as opposed to other theories. This theory help us to take a descriptive stand that may contribute to our understanding of the exciting issues of the role of individuals' fairness perception about taxation to improve tax compliance. On the similar note, social exchange theory argues that in any relationship beneficial treatment form one partner expects some reciprocation from another partner. This exchange helps to develop trustworthiness among partners.

Filing Compliance

Tax compliance is the willingness of taxable entities including individuals to comply with tax laws, accurate tax base reporting, accurate tax liability computing, and timely returns filing tax

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CJSSR
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filing, without any enforcement strategy. It also includes inclination of taxable entities towards the contribution into public finance (Kharisma, 2018; Tusubira, 2018-a). In fact, tax compliance is composed of three sequential steps including: tax return filing, accurate reporting, and tax liabilities payments. However, filing compliance is the crucial issue among emerging states, where the people have no attitude of filing tax returns. This non filing practice badly affects the tax revenue especially in budget constrained states, which leads towards economic inefficiencies (Alm et al., 2016; Santoro, 2021). Extant literature has studied tax compliance behavior, although filing behavior is needed to be studied. It is justified to hypothesize that individual decision to file a tax return is apart from decision about declaring tax liability. Moreover, income reporting is conditional on filing return. So, it is important to analyze the influence of contextual factors on individuals' decision about filing compliance.

Tax utilization disclosure

The importance of information disclosure to the taxpayer about the utilization of tax funds has already been stressed by scientists (Alm et al., 1993) and global organizations (Barometer, 2018), such as GIFT (Global Initiative for Fiscal Transparency). As taxes are used to finance public benefits, thus taxation can be interpreted as a social binding between the citizens and the state. In accordance to this contract, taxpayer, as its one party, is not only obliged to comply with taxation but also entitled to receive information form another party (state) about the allocation of tax money (Feld & Fey, 2007; Bird et al., 2008; Luttmer & Singhal, 2014). Considering the bigger picture, Transparency and accountability are the important issues in taxation because these build trustworthiness of the state which in turn enhance the voluntary compliance by the taxpayers (Al-Maghrebi et al., 2016; Augustine & Rufus, 2019). Recently, academic and nonacademic circles have focused the importance of transparency in state activities and it is believed that transparency leads to fiscal performance (Capasso et al., 2021). Another important study tested the association of tax transparency and tax compliance and through trust. This study was conducted on the individual taxpayers from service industries. This research illustrated insignificant relationship between tax transparency and compliance behavior but significant positive influence through mediation of trust (Siahaan, 2013). Seeking the importance of fiscal transparency, International Monetary Fund has proposed a code to enhance the reliability and transparency of reporting to citizens about public finance. This code is comprised of elements including tax forecasting, tax reporting, resource revenue management, tax risk management and some other particular rules and practices. IMF stresses the importance of fiscal transparency, as it helps to improve administration of public funds through which taxpayer can receive important information to access authorities' performance. The adoption of code by many countries indicates the importance of fiscal transparency to improve the creditworthiness of state governments.

A plethora of studies have tested the association of fiscal transparency and compliance behavior and defined transparency in different ways. According to Omolehinwa and Naiyeju (2015), fiscal transparency is the dimension of accountability which means to carry out all budgeting activities by the government with openness, so that nothing remain hidden in the public. Transparency helps to improve compliance behavior of taxpayers but if taxpayer found that government is not transparent, they might refuse to pay taxes (Siahaan, 2013). Another study give simple definition as transparency is the accessibility and understandability of government information given to the public for their decision making (Zvereva et al., 2021). OECD (2002) has described budget transparency as "the complete and accurate disclosure of all fiscal figures in a systematic manner

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and on time". And another definition provided by IBP (2008) is "accessibility to fiscal information especially about spending and revenues and other relevant information " (Al-Maghrebi et al., 2016).

In literature, three types of transparency have identified which are Information transparency, participatory transparency and accountability transparency. Firstly, Information transparency means provision of accurate, unequivocal, timely and balanced information which helps stakeholders to make respective decisions. Secondly, participatory transparency means giving right to stakeholders to participate in some aspect of decision making, so the information must be relevant and useful. thirdly, accountability transparency means responsible authorities are answerable for their actions, words, activities and various decisions in front of stakeholders (Augustine & Rufus, 2019; Siahaan, 2013)

Based upon above definitions of transparency and its categorization, the writer argues that information disclosure to the stakeholders is an important part of transparency. Studies in literature have stressed the role of information disclosure about the utilization of tax funds in building creditworthiness of tax authority. One of these studies states that Greater information disclosure leads to confidence of taxpayers about the rational utilization of tax revenue by the authorities provided by taxpayers to finance public goods. This information disclosure also helps to understand and supervise utilization of public resources, thus positively influence the fairness perception of the taxpayers about tax system (Bazart & Bonein, 2014). Moreover, Proper information disclosure and transparent decision-making process about tax utilization contributes to improve tax relations and stimulates the compliance by taxpayer. In short, tax utilization builds the culture of high tax morale. Disclosure of information about utilization of tax funds can help taxpayers to understand legitimacy of state tax policy. This technique can be used to control the situation of tax evasion. Tax utilization disclosure will help to build implicit contract between taxpayers and state, which will result into a new level of tax culture (Zvereva et al., 2021).

Taxpayer dissatisfaction arises because of lack of information about state fiscal decisions. Generally, citizens are not disclosed about the rules of prioritizing to finance public good and services. Lack of information can urge individuals to disapprove the (social) societal benefit out of taxation (Lamberton et al., 2013) and find it as burden imposed by authorities. This type of taxpayer disapproval may be for a specific period of time as taxpayer is not satisfied with the expenditures financed by tax funds (Cowell, 1992). For instance, the Vietnam War, in the USA, negatively affected the tax compliance. Moreover, in the states that are suspected or distrusted, tax evasion is often used by the citizens as reaction to distrusted states (Batrancea et al., 2019).

Against this problem of citizen dissatisfaction, information disclosure can be used as a tool to correct the beliefs of taxpayers and enhance their compliance behavior. Tax agencies are inclined to disclose enough information about state revenue and expenditure to public. The American "Taxpayer Receipt" and the British "HMRC Tax Calculator" are the notable examples of this disclosure (Cruces et al., 2013).

Above literature stresses the importance of tax utilization disclosure to improve citizen's satisfaction with the tax system. Meanwhile, we cannot ignore studies that found insignificant and negative relationship between information disclosure and taxpayers' satisfaction, in both field survey and experimental settings. Meta-analysis of field studies provided the evidence that informing taxpayer about the use of tax money does not seen to improve tax compliance (Antinyan & Asatryan, 2020)

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CJSSR
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Vol.04 No.01 (2026)

Another experimental study conducted on representative German sample concluded that information provision about tax fund allocation can reduce the support form taxpayer. Specifically, information disclosure is important for public who underestimate the public spending to correct their biased beliefs. While people who overestimate the public spending do not exert much attention over such disclosure (Abbiati et al., 2020; Lergetporer et al., 2016). So, conflicting findings of above studies urge the writer to analyze the nexus of tax utilization disclosure and tax compliance by individual taxpayers (Abbiati et al., 2020).

Some studies have focused on the psychological and cognitive angle of underlined relationship. Lamberton et al. (2014) argued that tax evasion is a psychological aspect which may be caused by the decoupling of tax obligation and the tax outcomes in terms of public goods. This decoupling leads to tax evasion, tax benefits are not the source of motivation for taxpayers at the time of compliance (Thaler, 1999). To deal with this issue, policymakers have started information disclosure especially about the granting of tax money across various state expenditure, to make taxpayers informed and satisfied (White House, 2011). Disclosure of information about tax outcomes helps to improve taxation compliance (Sussman and Olivola, 2011; Djawadi and Fahr, 2013).

H_1: Tax Utilization Disclosure has significant positive impact on Filing Compliance.

Taxpayers' Preference Elicitation

A group of studies conclude that when economic and political institutions involve citizens in decision making process, the likelihood of compliance with underlined policy increases. That's the reason, democratic policy making has proved more effective as compared to autocratic one (Alexander & Paterline, 2021; Beckett & King, 2002; Wang et al., 2020). On a similar note, another study highlighted the importance of citizenship. "Citizenship entails all the activities and responsibilities that are essential for healthy politics, such as participation and criticism in general. Practicing citizenship involves the engagement of citizens in governance and focusing the general good. "Active citizenship involves participation in decision making regarding taxation and considering the general good instead of focusing on the private gain. This phenomenon will help to get valuable contributions and insight in the fiscal decisions, from active citizens. (Beckett & King, 2002) Behavioral sciences also confirmed the relationship between citizen participation in decision making and compliance, as this inclusion motivates citizens to fulfill their promise honestly (McEWEN & Maiman, 1986). In context of tax compliance, literature shows that compliance is effected by the way tax fund is allocated to the expenditures. Taxpayers are convinced to tax evasion if they realize that they have no voice in selection in the utilization of their tax fund (AbdelNabi et al., 2021; Jacquemet et al., 2021).

Previous researches show that attitude of taxpayer is affected by the degree to which they believe to be involved by government in political decisions as well as in fiscal decisions. For instance, a study analyzed the impact of democratic institutions on tax compliance and found strong positive impact of democratic involvement on tax morale (Torgler, 2005). It is also found that tax evasion is lower in countries where budgetary decisions are taken democratically through public vote (Pommerehne & Weck-Hannemann, 1996). However, referenda and elections are not the only ways to involve taxpayer in government decisions. Moreover, it becomes very difficult to involve taxpayer in budgetary decisions because of its complexity and high cost of organizing elections and referenda (Abbiati et al., 2020).So, Lamberton et al. (2018) argued that taxpayer involvement can be confined to taxpayer preference elicitation. Such type of involvement can motivate taxpayers for compliance. If the taxpayers' opinion are not implemented in allocation

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CJSSR
CONTEMPORARY JOURNAL OF SOCIAL SCIENCE REVIEW
Vol.04 No.01 (2026)

of expenditures. This mechanism will help taxpayers to perceive themselves as a part of state decisions. Specifically it creates a sense of control over fiscal budget as well as builds expectations among taxpayer that their voice is considered while deciding about public spending Even Such type of involvement can mitigate the negative impact of high tax rates. Altogether, it is argued that if taxpayer is involved by tax authority, the probability of compliance would increase, as taxpayer involvement will help them to develop a perception of fairness and equity by tax authorities (Kirchler et al., 2008a; Tyler, 2006). So, if the tax authority listen to the opinion of taxpayer respect their voice, the compliance would enhance (Vihanto, 2003).

Recently, several studies document the significant impact of tax choice (i.e., participation of taxpayer in the assignment of tax funds to the public goods) on taxpayer intention to compliance (Abbiati et al., 2020). Similarly, Lamberton (2013) also found that tax choice enhance taxpayer satisfaction level with tax system.

Tax compliance/evasion is generally used by citizens to communicate their satisfaction/dissatisfaction with the state authorities (AbdelNabi et al., 2021; Mansour et al., 2021). Specifically, taxpayers tend to comply less in the periods when they do not approve the expenditures out of their tax money (Cowell, 1992). Taxpayer exclusion from expenditures decisions generate a conflict between taxpayer priorities and state preferences, which will induce a feeling of tax burden among citizens. It develops a sense of loss of control of budgetary decisions and general perception of enforcement and coercion (Li et al., 2011; Mir Djawadi & Fahr, 2013).

H_2: Taxpayers' Preference Elicitation has significant positive impact on Filing Compliance.

Facilitation

Venkatesh et al. (2012) narrated facilitation as "the degree to which taxpayer believes that an authority or infrastructure provide support to the compliance decision." Facilitating conditions are external components and objective conditions of an infrastructure that help people to exercise certain actions (Sichone et al., n.d.; Venkatesh et al., 2012). It is also found in another study that facilitating conditions can be categorized into two aspects: technological interventions and resource facilitating environment (Taylor & Todd, 1995). This factor has been studied in literature frequently. Out of it, prevalent studies define facilitating conditions in terms of technical support and helpful resources like computer facilities while interacting with e-fling platforms. Technical conditions have found to be significant factor effecting e-fling behavior (Rakhmawati et al., 2020; Tambun & Kopong, 2017; Wang et al., 2020). Facilitating conditions can also be measured in terms of degree of accessibility of required resources, helpful knowledge and necessary support to use electronic taxation system (Schaupp et al., 2010). Literature comprises of studies on e-governments, concluded that different e-government apps are sued by people who perceive it facilitating (Hung et al., 2013; Wang et al., 2020). In nutshell, facilitating conditions can be described as adequate knowledge, infrastructure, support system and technological interventions (Rakhmawati et al., 2020).

Tax compliance behavior can be incentivized by improved facilitating conditions (Gangl et al., 2015). In context of taxation, facilitating conditions include awareness and support system from tax authorities through work stations, telephonic services, online platforms, simplification of tax formalities, information services and cooperative and respectful communication from tax authorities to individuals (Alm & Torgler, 2011b; Braithwaite, n.d.; MAQSUDI et al., 2021; Nurkholis et al., 2020; Tjondro et al., 2019). Facilitating environment based on these facilitations helps taxpayers to fulfill their tax compliance requirements (Alm & Torgler, 2011b).

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CJSSR
CONTEMPORARY JOURNAL OF SOCIAL SCIENCE REVIEW
Vol.04 No.01 (2026)

H₃: Facilitation has significant positive impact on Filing Compliance.

Perceived Tax Outcomes

The traditional theoretical paradigm which is known as economic paradigm describes tax compliance with the respect of individual self-interest, which means individual makes rational choice and takes decisions that will maximize its individual outcomes in the scenario of uncertainty (Allingham and Sandmo, 1972). This paradigm omitted the importance of another dimension of the phenomenon, which include non-economic factors contributing to tax compliance (Bruno, 2019; da Silva et al., 2019; Wenzel, 2005). A number of researches have focused on non-economic factors in a very selective manner and studied the socio-psychological variables such as, tax morale, fairness perception, trust in tax authorities and tax services (Awadh Bin-Nashwan et al., 2020; Tjondro et al., 2019; Torgler, 2005). There is another important factor that taxpayers have right in public goods and services provided by government, as these are financed by tax revenue collected by tax authorities. So, taxpayers receive benefits out of tax payments. On the basis of collective identity, expectations about tax outcomes act as motivating factor towards compliance (Alm et al., 1993; Gobena & Van Dijke, 2017). People judge these societal outcomes rationally whether these are fair in terms of quality and quantity against the payments they have made as taxes (Verboon & van Dijke, 2007). So, if individuals perceive these collective outcomes as fair and effective for whole society, affects his/her compliance attitude (Alm & McKee, 1998). Finding of another important study concluded that degree of positive perception about accessibility and availability of collective benefits is the important factor explaining reasons for massive tax evasion, specifically in developing states (Umar et al., 2019). Alm et al. (1993) suggested too that perceived tax outcomes significantly affect taxpayers' willingness to fulfil tax compliance requirements.

H₄: Perceived Tax Outcomes have significant positive impact on Filing Compliance.

Perceived tax Fairness

Extant Literature support that taxpayers perception about fairness of tax dynamics helps improving compliance behavior among general public (Bordignon, 1993; Che Azmi et al., 2016; Vehovar et al., 2018). Taxpayers exhibit tax evasion behavior if they perceive prevailing tax system as unjust (Farrar et al., 2019). However, multiple dimensions of fairness perception are studied including retributive fairness, distributive fairness and general fairness along procedural fairness impacting compliance behavior of individuals (Mukasa, 2019; Tusubira, 2018.-b). Siahaan (2012) researched the influence of distributive and procedural justice and concluded that there is direct relationship between fairness perception about tax laws and tax compliance among individuals (Pommerehne & Weck-Hannemann, 1996). Fairness perception can be narrated as the individual imagination about the evaluation of a phenomenon by comparing one's own context with one self's own experience before and with others (Ariyanto et al., 2020).

Benk et al. (2012) surveyed the tax professionals in turkey and found tax fairness, which means fair distribution of tax burden, as most important variable contributing to voluntary compliance with taxation. However, another group of studies have found the contrasting results that there is no relationship between fairness perception and tax compliance (Mason & Calvin, 1984).

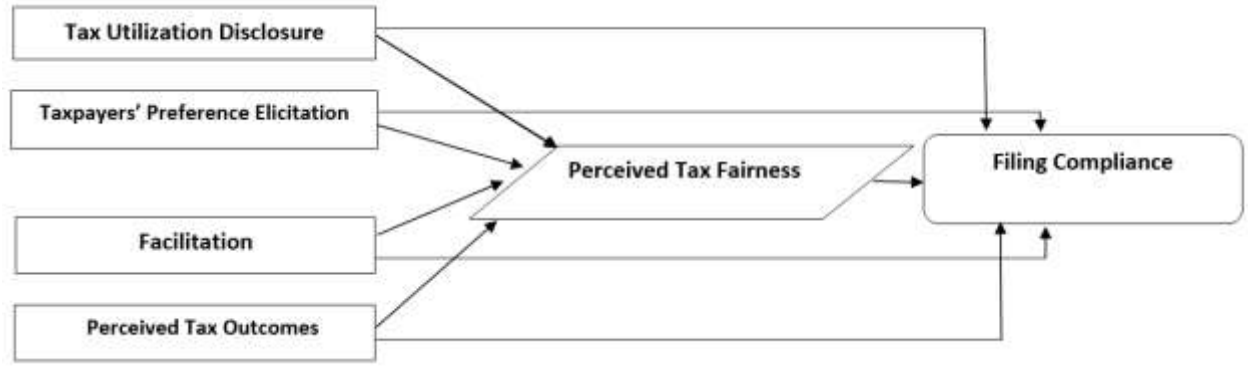
With the implication of social exchange theory and fairness heuristic theory, researcher argues that all the contextual factors discussed above are influential to improve filing compliance through developing fairness perception of individuals. Thus there is a need to test fairness perception as mediator between constructs i.e. tax utilization disclosure, taxpayers'' preference elicitation, facilitation and perceived tax outcomes and tax compliance.

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CJSSR
CONTEMPORARY JOURNAL OF SOCIAL SCIENCE REVIEW
Vol.04 No.01 (2026)

H5: Perceived Tax Fairness significantly mediate the association between Tax Utilization Disclosure and Filing Compliance.
H6: Perceived Tax Fairness significantly mediate the association between Taxpayers' preference Elicitation and Filing Compliance.
H7: Perceived Tax Fairness significantly mediate the association between Facilitation and Filing Compliance.
H8: Perceived Tax Fairness significantly mediate the association between Perceived Tax Outcomes and Filing Compliance

Conceptual Framework

Figure 1: *Proposed Conceptual Framework*



Source: Authors Compilation

Operational Definitions

Total constructs used in this study are six, which are conceptualized and operationalized with the help of literature.

Table I

Operational Definitions of Constructs

Constructs	Operational Definitions
Tax Utilization Disclosure	IBP (2008) " The perceived ability of all the people in a country to access the information on how much is allocated for different types of spending and what revenues are collected" (Al-Maghrebi et al., 2016).
Taxpayers' Preference Elicitation	Perceived degree of involvement of taxpayer in the allocation of tax funds to the public goods (Abbiati et al., 2020).
Facilitation	Venkatesh et al. (2012) define facilitation as "the degree to which an individual believes that an organization and infrastructure exist to support compliance decision."
Perceived Tax Outcomes	Perceived accessibility and availability of public goods which are fair in terms of both quantity and quality against tax money (Umar et al., 2019).
Perceived tax Fairness	The global perception of appropriateness of taxation system (Colquitt & Zipay, 2015).

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CJSSR
CONTEMPORARY JOURNAL OF SOCIAL SCIENCE REVIEW
Vol.04 No.01 (2026)

Filing Compliance	Willingness to submit income returns to tax authority, timely and accurately.

Conclusion

Strong taxation system is very important for resilient economy. Citizens' Trust in tax authorities leads to healthy taxation system and tax compliance. Countries around the world are working on trust paradigm to sustain public trust. Perception of taxpayers about tax fairness is very important to shape up the tax culture in a state. In turn, this perception is developed through contextual factors. This notion is based upon the argument that individuals do not always behave rational, selfish and self-interested as assumed in enforcement paradigm, but rather are motivated by contextual factors, which incentivize compliance behavior through building mutual trust between state and the taxpayer. So the importance of contextual factors of taxpayers in making compliance decisions cannot be ignored (Alm & Torgler, 2011a).

Fairness Heuristic Theory, argues that participants do not always have direct and relevant information about a particular phenomenon to make fairness judgments and decision. So, people process contextual information heuristically to make fairness judgment about a certain phenomenon. Thus, fairness heuristic theory offers a more contextual account of the justice judgment instead of direct and relevant information as opposed to other theories. This theory help us to take a descriptive stand that may contribute to our understanding of the exciting issues of the role of individuals' fairness perception about taxation to improve tax compliance.

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