

THE IMPLICATIONS OF TAX MORALE ON TAX COMPLIANCE BEHAVIOR

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The present paper focuses on the analysis of tax compliance behavior from the tax morale standpoint. We grounded our research on the idea that empirical studies constantly invalidating the assumptions of theoretical models of tax evasion show there are more factors influencing compliance than just the economic ones (e.g., audit probability, fine, tax rate, income). Giving the fact that audit probabilities are generally very low and that tax evasion is not as high as one could expect, tax morale might have to do with the high degrees of tax compliance registered around the world. In a stream of articles on taxation published beginning with the late 60's, tax morale defined as the intrinsic motivation to comply or "internalised obligation to pay tax" (Braithwaite and Ahmed 2005) has been found to positively relate to tax compliance and negatively relate to shadow economy. This paper attempts to offer a broader view on the influence of tax morale on compliance behavior, covering articles ranging from national and cross-cultural surveys to experimental games. Moreover, the aim of the article is to emphasize the policy implications of tax morale research and the changes governments could make in order to raise the amount of public levies.

Keywords: tax morale, tax compliance, shadow economy, corruption index

JEL Codes: G02; G28; H26

1. Introduction

The concerns for taxation and the implications of tax compliance behavior on society development are as old as mankind. As Torgler (2007: 3) emphasizes, the very first details about taxation came from Ancient Egypt where pharaohs, much like today's policy makers, were trying to reduce corruption among the tax collectors called *scribes*. The methods applied by the Egyptians rulers can find correspondence nowadays: tax collectors were given high salaries to be less tempted to cheat on taxpayers; tax collectors working in the field were supervised by special tax collectors. Furthermore, the Rosetta Stone (the artifact that decoded the hieroglyphic writing system, carved in the times of king Ptolemy V) is the first tax-related document ever to mention a tax amnesty. Besides watching over the tax system, some pharaohs cared about how taxpayers' were treated. Adams (1994: 8) reports that tax collectors were taught to act kindly towards taxpayers, especially the needy ones: "If a poor farmer is in arrears with his taxes, remit two-thirds of them"; "cheer up everyone and put them in good humor"; "if anyone is suffering under the pressure of taxation or is at the end of his means, you must let the case go unchecked". According to CPA Marc Gilfillan, the last lenient policy abovementioned was called "philanthropa", from which later derived the word "philanthropy". Since then, even though tax authorities have changed the way they relate toward needy taxpayers (by offering tax incentives but not remitting tax liabilities), compliance behavior remained the same, with some taxpayers searching for loopholes into the law to *avoid* taxes or deliberately breaking the law to *evade* taxes and others doing the right thing by *paying* their tax liabilities.

Tax compliance decisions have always been of interest to researchers trying to answer one of the most puzzling questions: why people pay taxes (Cullis and Lewis 1997; Andreoni et al. 1998; Alm and Torgler 2011). According to the assumptions of the classical tax evasion model

(Allingham and Sandmo 1972; Srinivasan 1973), deterrence policies are the key in increasing tax compliance because tax evasion is negatively correlated with the audit probability and punishment degree. The studies that followed (Yitzhaki 1974; Erard and Feinstein 1994) solved some of the inconsistencies of this model but not its main shortcoming: the model predicts too much tax evasion and too little compliance. Observing the high levels of tax compliance registered around the world, some researchers assumed it is due to factors other than economic ones (e.g., audit probabilities, tax rates, penalty rates, income). Hence, they singled out tax morale as one important determinant of tax behavior. The remainder of the paper is as follows. Part 2 presents a stream of surveys and experiments which analyze tax compliance behavior with focus on tax morale. Part 3 stresses some policy implications of the results reported by the tax literature. Part 4 summarizes the main ideas of the paper.

2. Tax morale related studies: surveys and experiments

The term “tax morale” was coined by Schmolders back in 1960 who defined it as “the attitude of a group or the whole population of taxpayers regarding the question of accomplishment or neglect of their tax duties; it is anchored in citizens’ tax mentality and in their consciousness to be citizens, which is the base of their inner acceptance of tax duties and acknowledgement of the sovereignty of the state” (Schmolders 1960: 97-98). Despite the definition given by Schmolders, tax morale is still a debated notion with different meanings. According to Feld and Frey (2002) or Braithwaite and Ahmed (2005), tax morale is perceived as the “internalized obligation to pay tax”. Alm and Torgler (2006) see it as the “intrinsic motivation” to pay tax liabilities, Orviska and Hudson (2002) relate it to civic duty, whereas Torgler and Murphy (2004) link it to tax ethics. The various opinions about tax morale are understandable in the light that morale poses a problem for economic analysis: it cannot be observed directly, therefore it can be assessed only by looking at its effects (Pommerehne et al. 1994).

One of the most popular research methods to elicit and analyze tax morale is through surveys. Respondents are usually presented with taxpaying situations which have to be assessed according to their system of beliefs or different variables of interest. In this sense, the World Values Survey (WVS) database is a valuable source of comprehensive information on different political and socio-cultural issues, including taxation. Assuming that tax morale is an important determinant of tax compliance behavior, it is necessary to understand the factors that shape one’s level of tax morale. Relative to this, Torgler and Murphy (2004) investigate the level of tax morale among Australian citizens using WVS data collected between 1981 and 1995. According to their analyses, trust (i.e., in Parliament or the legal system) and moral beliefs (i.e., religiosity) are key determinants of the tax morale degree in Australia. Besides reporting a significant increase in tax morale since the beginning of the 1980s, the authors also note that the rate of increase is higher compared to other OECD countries. Alm and Torgler (2006) study the link between tax morale and the size of the shadow economy in USA and 15 European countries across several years using World Values Survey data. The authors report a strong negative correlation between the size of the shadow economy and the degree of tax morale in the respective countries. The highest degree of tax morale is reached in the USA, followed by Austria and Switzerland. Stepping out of the research trend focused on assessing individuals’ tax morale degree, Alm and McClellan (2012) analyze the effect of tax morale on tax compliance behavior using data from Business Environment and Enterprise Performance Surveys (BEEPS) and the World Enterprise Survey (WES) on 8,500 firms in 34 countries, during a period of 8 years. The reported results show that tax morale considerations are the same for individuals and firms: firms having higher tax morale evade less than those with lower tax morale. Moreover, as foreign firms and state owned forms seem to evade less than domestic firms, the authors suggest that governments should increase audit probabilities for domestic firms.

Investigating the link between the inefficiency of public spending and tax morale, Barone and Mocetti (2011) report that the attitude towards paying taxes (i.e., tax morale) improves when public resources are spent more efficiently. In addition, the authors show that the negative effect of inefficiency is even more significant when the level of public spending is lower and/or fiscal autonomy is higher. In the same vein, Torgler and Werner (2005) bring strong evidence supporting the idea that higher fiscal autonomy generates higher tax morale, therefore more tax compliance. Dell'Anno (2009) shows that tax morale can account for the level of aggregate tax evasion and it depends on taxpayers' inner attitudes toward honesty and social stigma. Torgler (2005) suggests that direct democracy positively influences tax morale. Torgler et al. (2008) find a significant correlation between tax evasion and tax morale after controlling for various factors: tax administration; tax system and the perceived tax burden; tax awareness; compliance perceptions; trust in authorities and other citizens; corruption; willingness to obey the law and religiosity.

Besides assessing the degree of tax morale from self-reported attitudes, it can also be assessed through experimental games with monetary incentives in which participants are exposed to frameworks resembling real-life taxpaying situations. Generally, behavioral patterns elicited through experiments are somewhat different from the self-reported ones because surveys analyze what people would do in a certain situation while experiments analyze what people actually do in a certain situation. Feld and Tyran (2002) report results from a one-shot tax evasion game on the impact of voting on tax compliance. According to their experiment, tax morale is higher when participants have the possibility of approving or rejecting the proposal of a fine. In a two-treatment public goods game experiment depicting an economy composed of two regions, Güth, Levati and Sausgruber (2005) test the effect of centralization versus decentralization on tax morale. In the decentralization treatment, taxes are levied locally and used exclusively for the benefit of the members from a specific region. In the centralization treatment, taxes are levied globally and divided between the two regions on a per capita basis. The authors report that centralization generates a lower degree of tax morale and inefficient outcomes.

3. Policy implications of tax morale research

As shown by the manifold of empirical studies, there is a strong positive correlation between tax morale and tax compliance: the higher the degree of tax morale, the higher the level of tax compliance. Based on these results, tax authorities could develop fiscal policies to foster tax morale and eventually compliance, without disregarding the words of Martin Luther King: "Morality cannot be legislated but behavior can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless". Some aspects concerning policy implications of tax morale studies will be presented as follows. In a hypothetical evolutionary model of economy with a dynamic setting, Pommerehne et al. (1994) investigate the link between tax morale and the performance of different political systems. Particularly, they focus on representative democracies (people vote for representatives who then vote on bills and policy initiatives) and direct democracies (people vote on bills and policy initiatives directly, without being represented). The study reports that tax morale is higher in direct democracies. Concerning the elements of deterrent policies, representative democracies are more prone towards intensive audits whereas direct democracies favor higher fines. According to the authors, the reported results show that the performances of direct democracies (degrees of tax morale and tax compliance) are better than the performances of representative democracies, due to the fact that direct democratic systems have a higher probability of survival in an evolutionary process.

Taking into account the fact that tax morale encompasses taxpayers' inner motivation to pay taxes, tax authorities should apply different strategies other than deterrent ones in order to raise compliance. Two notable examples come from the Australian Taxation Office and the New Zealand Inland Revenue which use a set of various strategies depending on the type of taxpayers:

“make it easy” compliance strategy for taxpayers willing to do the right thing; “assist to comply” for taxpayers who try but don’t always succeed; “deter by detection” for taxpayers who don’t want to comply; “use full force of the law” for taxpayers who have decided not to comply (Morris and Lonsdale 2004). Moreover, they provide professional assistance to first-time business owners in order to raise awareness about the importance of taxpaying and the sanctions they face for disregarding tax law. These strategies proved to be very efficient. For example, in New Zealand, the self-employed group registered better taxpaying performance in 2003 compared to 2002: 43% decrease in the number of outstanding returns; 22% decrease in the number of debt cases; 16% decrease in the amount of outstanding debt (Morris and Lonsdale 2004: 69). Among the four abovementioned strategies, two were applied also by the Romanian tax office, i.e., “make it easy” and “assist to comply”. In 2009, authorities set up a national campaign called “The tax office gets out on the street” to increase the degree of tax morale and compliance level. As an immediate consequence of the campaign, the number of income tax returns increased by 15% compared to the same period in 2008. Furthermore, the national online tax payment system launched in 2011 with the aim of facilitating compliance process and mitigating bureaucracy proved to be rather successful: online tax payments totaled 400,000 Euros in 2012, out of which 10% were payments performed from outside the country.

Bearing in mind the reported negative correlation between the degree of tax morale and the level of the shadow economy (Torgler and Schneider 2007, 2009), governments could design policies that foster tax morale and hinder taxpayers’ propensity to engage in cash transactions. Generally, higher tax morale brings nothing but benefits for the entire society because it: ensures financial resources for the provision of high quality public goods; decreases the costs with implementing deterrent policies for identifying tax avoiders, chasing and prosecuting tax evaders (qualified tax officers, state-of-the-art monitoring systems, abstruse tax law); helps creating a stable business environment as a prerequisite for economic growth. By analyzing the abovementioned positive effects generated by tax morale and by corroborating them with the most recent corruption perception index, it is easily observed that the countries with the highest tax morale, highest tax compliance level and the most stable economic environments are developed democratic ones. The explanation is straightforward: democracy fosters social responsibility, which is mandatory for the emergence of tax morale. In a comprehensive study, Alm (2011) stresses various policies governments could ultimately adopt in order to improve tax compliance: increase taxpayers’ awareness that paying taxes is the right thing to do and assures the provision of high quality public goods; display publicly the tax evaders; avoid policies which imply that tax evasion is morally acceptable; increase taxpayers’ involvement in the allocation process of tax money; solve the issue of perceived inequities in the tax system.

4. Conclusion

Noticing the failure of the standard economic model of tax evasion in predicting tax behavior, researchers looked for an explanation to the high degree of tax compliance found at global level. As Alm and Torgler (2011: 635) noticed: “Still, the puzzle of tax compliance is not why there is so much cheating. Instead, the real puzzle is why there is so little cheating. Typically, the percent of all individual income tax returns that are audited is often less than 1% and the penalties on even fraudulent evasion are only a fraction of unpaid taxes. Virtually all economic models of taxpayer behavior conclude that there should be much more tax evasion than is actually observed. However, most people pay most of their taxes most of the time”. Based on extensive evidence from surveys and experimental games, researchers consider tax morale to be one of the main determinants of tax compliance. The literature focused on the link between tax morale and compliance behavior consistently reports a positive correlation of the two elements. Generally, countries with a high degree of tax morale register a high degree of tax compliance and a low shadow economy. Hence, governments are called to perform several policy changes in order to

corroborate scientific research and economic reality and ultimately increase tax compliance levels, among which: simplify taxpaying procedure; make taxpayers aware that paying taxes is the right thing to do; promote fair tax systems; focus more on cooperative rather than deterrent policies.

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Acknowledgements

¹Investing in people! Ph.D. scholarship, Project co-financed by the Sectoral Operational Program for Human Resources Development 2007–2013 Priority Axis 1. "Education and training in support for growth and development of a knowledge based society"; Key area of intervention 1.5: Doctoral and post-doctoral programs in support of research. Contract no.: POSDRU/88/1.5/S/60185– "Innovative Doctoral Studies in a Knowledge Based Society"; Babeş-Bolyai University, Cluj-Napoca, Romania.

²This work was supported by the project "Post-Doctoral Studies in Economics: training program for elite researchers–SPODE" co-funded from the European Social Fund through the Development of Human Resources Operational Program 2007-2013, contract no. POSDRU/89/1.5/S/61755.