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Reactance to taxation: Employers' attitudes towards taxes

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Abstract

Taxes limit an individual's freedom to make autonomous decisions about his or her income. A person is likely to respond to restrictions on his or her own freedom or perceived restrictions by reactance if opposition is a promising means for reestablishing the initial situation. Reactance as a consequence of perceived limitation of freedom is likely to manifest itself through change of attitudes, tax morale, and tax behavior. It is hypothesized that employers who have been running their business only a short time perceive taxes as a drastic cut in their profit and possibilities for investments and tend to feel limited their freedom and consequently display reactance more than employers who have had more extensive experience with their firms and the tax system. A sample of 117 employers with one or more dependent workers completed a questionnaire on (a) perceived limitation of one's freedom through tax obligations, (b) attitudes towards tax evasion, (c) moral standards with regard to paying taxes, (d) actions to reduce or avoid taxes, and (e) demographic characteristics. As predicted, perceived restriction of freedom was correlated with positive attitudes toward tax evasion, lower tax morale, and reported tendencies to act against paying taxes. Employers who had run their firm only a short time felt greater loss of freedom and displayed greater reactance than employers with more extensive experience.

1. Introduction

1.1. Determinants of tax behavior

Citizens' contributions to public revenues are certainly a matter of frequent dispute. Achieving a just distribution of burdens and the reasonable investment and use of common resources are controversial issues on the agendas of politicians, legal advisors, and social

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scientists and often constitute sources of societal discomfort. Income taxes, in particular, are a type of contribution which working people feel forced to pay without always perceiving to receive an equivalent in return.

Tax behavior can be studied within the paradigm of social dilemmas (Dawes, 1980; Maital, 1982). If everyone trusts everyone else and pays what he or she owes, everyone benefits from the public budget. In other words, cooperation pays if everyone cooperates. However, if others' behavior is uncertain, cooperation is risky. Non-compliant partners take the most if others contribute their part. According to standard economic theory, defection is the rational choice if the behavior of others is not known: taxpayers are best off if they evade—given that the probability of detection and fines is reasonable low (Allingham and Sandmo, 1972).

Whereas tax avoidance is not illegal, evasion is the illegal reduction of one's tax bill. Tax evasion is defined as intentionally paying less taxes than the law requires, as a deliberate act of non compliance (Hessing, Elffers, and Weigel, 1988). Payers of income tax typically underreport their income and/or exaggerate deductible expenses when filing their returns. The cost of discouraging non cooperation is naturally high: tax returns have to be controlled frequently by tax officials and cheating must be severely punished. Economic models hold that taxpayers are rational optimizers who will declare as little of their income as possible unless evasion is too risky and does not pay.

Besides economic constraints to compliance, there are also psychological and situational factors associated with tax behavior. Weigel, Hessing and Elffers (1987) and Webley, Robben, Elffers and Hessing (1991) propose a social psychological model for evasion behavior which was formulated on the basis of several former theoretical frameworks (e. g., Groenland and Van Veldhoven, 1983; Lewis, 1982; Song and Yarbrough, 1978; Spicer, 1975; Strümpel, 1969; Vogel, 1974). According to their model, tax evasion depends on (a) situational instigations, such as financial strain, defined by the amount of taxes owed after withholding; social norms which emphasize an individual's wealth as a measure of success within a reference group; (b) situational constraints, such as the opportunity to evade, legal rigor of tax investigations and fines, social controls, such as the percentage of evaders within a reference group or the social disapproval of evasion; (c) personal instigations, such as personal strain (e. g., perceived fairness of tax laws, difficulties in meeting tax obligations), and personal egoistic orientations versus altruistic ones; and (d) personal constraints, such as perceived opportunity to evade, perceived risk of punishment and intolerance of norm transgressions.

Several studies support Weigel et al.'s (1987) theoretical framework. Wärneryd and Walerud (1982), for instance, show that people under financial strain are less willing to pay taxes than others. Lewis (1982) and Groenland and Van Veldhoven (1983) report that personality characteristics (e. g., dependency on norms), ideological and religious values, and moral orientations influence tax behavior. Falkinger (1995) emphasizes the importance of feelings of justice within an economic system. Schepanski and Shearer (1995) found high correlations between reported compliance and the probability of tax controls. They also report a withholding phenomenon, namely that behavior differs, depending on a person's tax balance and respective underwithholding with additional payment or overwithholding with returns. Wallschutzky (1984) found that tax behavior depends on the possibilities of norm

breaking: entrepreneurs have more possibilities to avoid paying taxes and use these possibilities more often than employees. Determinants of tax behavior need, however, to be interpreted with caution: According to Hessing et al. (1988), two separate complexes of explanatory variates exist: Depending on the method of assessment either attitudes or personality characteristics account for one's tax behavior. Self reports on tax evasion show that attitudes and subjective norms are significantly correlated with tax evasion. Observational data, on the other hand, suggest that dissatisfaction with the government, tolerance of illegal actions, competitive orientations and egoistic motives strongly affect tax behavior.

1.2. Perceived restriction of freedom and reactance

Taxes limit an individual's freedom to make autonomous decisions about his or her income. Whereas employed people get their net income with taxes already deducted, entrepreneurs and the self employed get their profit and gross income, respectively, and need to pay income taxes "out of their pockets." Entrepreneurs and the self employed may perceive taxes as a loss of their already possessed money and perceive their freedom to decide about their finances threatened and restricted. Loss of money which a person already possessed should lead to more intense negative feelings than loss of money which a person never had in his or her hands but which was withheld from the gross income. This assumption derives from value functions discussed in prospect theory (Kahneman and Tversky, 1979).

People often respond to restrictions on their freedom or perceived restrictions by undertaking actions to reestablish their lost freedom. Brehm (1966) has developed a theory based on the notion that people want to reestablish their threatened freedom. According to his reactance theory, people display a concern for independence by resisting the attempts of others to limit their freedom of decision. Brehm (1966, p. 4) suggests that a person who has a set of free behavior alternatives, "will experience reactance whenever any of these behaviors is eliminated or threatened with elimination." Reactance may come from a possible loss of control over events or a reduction of choice alternatives and develops into a motive to resist if the individual perceives a chance to reestablish his or her former situation (Wortman and Brehm, 1975). A person can reestablish freedom by choosing the opposite behavior to what is desired by the manipulative source and by accepting the observed opposition or resistance by another person. If a person perceives taxes as a loss of freedom he or she is likely to develop reactance. Reactance can be conceived as motivation to reestablish freedom by developing negative attitudes towards the government and taxes in general. Moreover, reactance may manifest itself by decreasing tax morale (Schmolders, 1966), that is, acceptance of other peoples' antitax behavior. Finally, those who have the opportunity to evade taxes by exaggerating costs and lowering income, may be inclined to change their behavior and avoid or evade taxes (Pelzmann, 1985).

The greater a person's motivation to control his or her choices, the more intense reactance should be. It can be assumed that especially entrepreneurs who take the risk of establishing an enterprise perceive taxes as a severe reduction of their profit and possibilities for reinvestment. Since entrepreneurs have possibilities to avoid and/or evade taxes, reactance motives may lead to such behavior tendencies.

The more experience an entrepreneur has accumulated in the course of time, the more

certain he or she is that the firm will continue to operate despite high taxes, and the more he or she has adapted to the national tax system, the lower reactance should be. Employers not only have greater opportunities to evade than other categories of taxpayers but during the start-up phase of their enterprise they may have stronger motives to respond by reactance. Opportunities and reactance motives together would explain employers' admittance of more frequent evasion than workers' (43% versus 13%; Wallschutzky, 1984).

The following study investigates employers' reactance to taxes as dependent on the length of time an enterprise has existed. It is hypothesized that experiences of limited freedom through taxes lead to reactance. Reactance manifests itself by negative attitudes towards taxes, low tax morality, and avoidance of taxes. Reactance is hypothesized to depend on the number of years an employer has run his or her firm. Since age of respondents is expected to be correlated with length of time running an enterprise, age will be controlled. Besides age, Since age, demographic characteristics of participants, such as sex of respondents, and the number of workers employed in one's firm, are controlled.

2. Method

2.1. *Participants and procedure*

Subjects were Austrian employers running small or medium-sized enterprises employing one or more workers. Questionnaires were mailed to 450 addresses which were chosen from local trading lists with computer firms and computer shops, cosmetic firms, installation firms, and food stores. Overall, 128 employers responded, yielding a response rate of 28.4%. Eleven questionnaires were not filled out completely and discarded, leaving a final sample of 117. One third of the participants were females, two thirds males. Average age amounted to 41.16 (sd = 10.61) years. Twenty-one percent of the cases duration of enterprises was less than two years; 29 percent of respondents run their firm since three to five years; 17% six to ten years and one third was run the firm since more than ten years. Two thirds of the firms employed one to five workers; ten percent employed six to ten workers and the remaining 22% employed more than ten workers.

2.2. *Material*

A questionnaire was developed to assess (a) perceived loss of freedom due to tax obligations, (b) attitudes towards tax evasion, (c) moral standards with regard to tax paying, (d) actions to reduce or avoid taxes, and (e) demographic characteristics such as sex, age, years running the enterprise, number of employees, and branch of the enterprise.

The initial questionnaire included eight questions for assessing loss of freedom, six items related to attitudes, ten items taken from Schmölders (1966) for assessing morality and four questions regarding actions. Statistical analyses of the questionnaire finally yielded a reduced list of items. Factor analysis of the complete item set with varimax rotation confirmed the expected four factors: three items (e. g., tax obligations limit my business; tax authorities' control of my business makes me feel watched) measured loss of freedom; five items loaded

Table 1

Means, standard deviations, and correlations between loss of freedom, attitudes toward tax evasion, morality, and actions to avoid taxes

| | m | std | N | loss of freedom | attitudes towards evasion | low morality | actions against obligations |
|-----------------|------|------|-----|-----------------|---------------------------|--------------|-----------------------------|
| loss of freedom | 3.32 | .93 | 117 | | .11 | .00 | .44** |
| attitudes | 2.43 | 1.17 | 117 | | | .52** | .37** |
| morality | 3.29 | 1.07 | 117 | | | | .36** |
| actions | 2.88 | 1.16 | 117 | | | | |

The higher the mean values the higher perceived loss of freedom, the higher attitudes favoring tax evasion, the lower the morality, and the stronger tendencies to avoid taxes.

** = $p < .01$.

on the attitudes factor (e. g., whoever has a chance to avoid taxes, should take advantage of it; whoever evades taxes behaves unfairly towards others); four items measured tax morale (e. g., person S used the telephone in part privately, in part for business. The monthly bill, however is entered in the books as a business expense; person Z earns some money by moonlighting, e. g., seminars, publications. This income is rarely less than ten percent of his or her officially reported annual income; these items were taken from Schmölder's, 1966, questionnaire on tax morale); three items assessed intended tax behavior (e. g., I feel obliged to spend money so I can reduce my taxes; at the end of the year, I think of new tax-deductible investments I could make). Responses on the respective items (given on 5-point Likert-type scales) were averaged. High values indicate loss of freedom, attitudes in favor of taxes evasion, low morality and tendencies to avoid taxes.

3. Results

It was hypothesized that perceived loss of freedom through tax obligations would result in reactance, that is, attitudes accepting tax evasion, lower morality and higher tendencies to avoid taxes. Correlations between the four dimensions show that perceived loss of freedom co-varies with antitax attitudes and approval of tax avoidance. Morality and attitudes were not significantly correlated with loss of freedom (Table 1).

Second, it was assumed that entrepreneurs who had been running their enterprise for only a short time would experience intense loss of freedom and show higher reactance than those who had been running it for an extended period of time and who had experienced profits despite tax obligations and/or who had adapted to the tax system. The correlation between the duration of the enterprise and perceived restriction of freedom amounts to $r(117) = -.20$; $p < .05$. Since the length of time running a business is correlated with the age of employers ($r(117) = .72$; $p < .01$), employers' age was partialled out of the correlation. Still, it was found that employers who had run their business for only a short time developed stronger feelings of limited freedom than those who had managed their firm for many years ($r(117) = -.18$; $p < .05$). Neither age ($r(117) = -.09$; $p > .05$), sex ($r(117) = -.04$; $p > .05$), nor

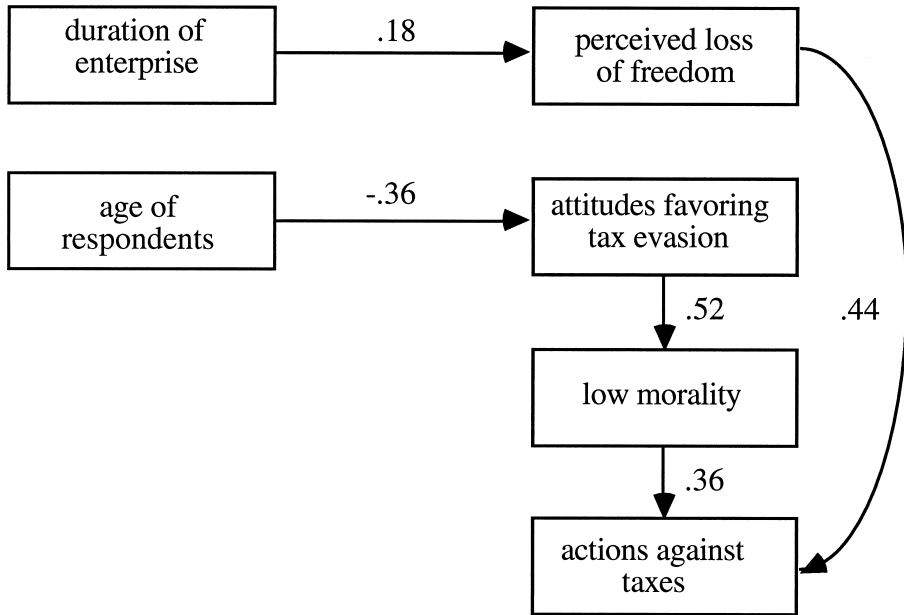


Fig. 1. Structural model (beta weights)

the number of employees ($r(117) = -.16$; $p > .05$) were significantly correlated with perceived loss of freedom. Also, sex and number of workers employed were not significantly correlated with perceived loss of freedom ($p > .05$). The relationships between duration of enterprise (controlled for age), age of respondents, loss of freedom, attitudes, morality, and actions were studied simultaneously within a structural equations model (LISREL). From a conceptual point of view, the model assumes that duration of enterprise and age of the employer determine perceived loss of freedom as well as other variables expressing attitudes towards and behavior with regard to taxes. Loss of freedom itself should lead to attitudes favoring tax evasion, lower moral standards and to approval of tax reducing actions. Also attitudes and low morality should be correlated with tax avoiding actions. Figure 1 represents the results of the best fitting model.

Overall, 97% of the variance can be explained: general fit was chi-square ($df = 9$) = 11.23; $p = .26$; the adjusted goodness of fit index amounted to .97; the root mean square residual, which indicates non explained variance and should be close to zero, was .07. As predicted, duration of running an enterprise had a significant effect on perceived loss of freedom through tax regulations. Loss of freedom was significantly related to antitax behavior. Antitax behavior was found also dependent on tax morale and attitudes towards taxes. Age of respondents had a significant effect on tax attitudes.

4. Conclusion

This study was designed to test the importance of perceived limitation of freedom upon development of attitudes towards tax evasion, morality, and actions aimed at reducing tax

payments. Moreover, it was hypothesized that the length of running a business would determine perceived restriction of one's freedom and reactance motives. It was assumed that attitudes towards tax evasion would become intense and actions against paying taxes would be a likely way to escape the perceived loss of freedom of choice. Both hypotheses are supported by the data. As Pelzmann (1985) emphasizes, loss of freedom and reactance motives determine tax behavior intentions and persons who establish a small or medium business or take the risks of investing in a new branch experience intense reactance. Perceived restrictions of one's freedom of choice was directly linked to behavior tendencies. No causal link was found between perceived freedom and antitax attitudes and morale. In some cases actions against taxes may be taken before attitudes have changed and attitude change may be a consequence of behavior. Falkinger (1988) argues, for instance, that change of behavior serves as rationalization of past behavior. Perceived loss of freedom and reactance decrease after years of experience with one's own firm and perhaps trust in the profitability of one's business, as well as adaptation to the tax system. Interestingly, perceived loss of freedom does not correlate with age. As expected, older participants are more likely to have run their firm for a greater number of years than younger participants. The correlation between years in business and perceived loss of freedom remains almost identical also after partialing out age.

Age was found to be correlated with attitudes towards tax evasion. Younger participants favored tax evasion more than older ones. Strümpel (1966) already reported a similar finding and argues that young people may differ from older people in value orientations. Whereas the young entrepreneurs consider their professional career and independence to be most important, the older and more experienced rely on the welfare state, and the pension system. For the latter, taxes are justified whereas the young may not perceive any significant personal return. Moral standards, measured as approval or disapproval of tax delicts (Schmölders, 1966) and action taking, were not directly dependent on age but turned out in the structural model to be a result attitudes. In conclusion, the importance of perceived loss of freedom should be emphasized. Limitation of personal freedom of choices and/or actions, even if necessary for establishing public goods, may have exactly opposite effects from the ones desired. Not only may individuals who experience loss of freedom successfully escape the perceived pressures, but the mere act of observing someone who directly or indirectly restores his or her own freedom can serve, by implication, to restore the freedom of observers (Brehm, 1966, p. 11). Perhaps citizens' slowness in condemning tax offenses can be explained at least in part as a restoration of their own limited freedom.

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