

MANAGING AND MAINTAINING COMPLIANCE

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1 | **MODELLING TAXPAYERS' BEHAVIOUR AS A
FUNCTION OF INTERACTION BETWEEN TAX
AUTHORITIES AND TAXPAYERS**

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1. INTRODUCTION

Tax non-compliance is a universal phenomenon. It takes place in all societies, in all social strata, in all professions, in all industries, in all religions and in virtually all economic systems. Scholars as far back as Plato wrote about the phenomenon, and the 15th century Ducal Palace of Venice features a drop box through which people could inform the Republic about tax evaders (Adams, 1993; Tanzi & Shome, 1994). Governments as far back as ancient Egypt have struggled to maintain compliance with tax laws (Erard, 1997). It is therefore surprising how little scientific attention this phenomenon had received until recent years. Only during the past 25 years has the subject of tax compliance come into its own as a research area within economics and economic psychology. Since then, studies on tax behaviour have significantly increased, and methods and techniques to study evasion have become manifold. This, however, is also an issue of concern since the results obtained in different studies are heterogeneous.

In the present article, we argue that some heterogeneity in results can be reconciled by considering the relationship between the authorities and the taxpayer. The interaction climate between them can range on a continuum between a *cops and robbers* climate and a *service for clients* climate. It can be characterized by mutual distrust on the one end and mutual trust on the

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other. In a climate of distrust, the power of the authority to control taxpayers becomes a matter of enforcing tax compliance through audits and fines. In a climate of trust, voluntary tax compliance is a matter of social representation, including tax mentality, personal and social norms and fairness perceptions.

The remainder of this article is structured as follows: first, economic-psychological tax research is briefly summarized. Then the interaction between tax authorities and taxpayers and resulting tax climates are described. After that a model of tax climate and tax compliance is presented, which can serve both as a conceptual tool to integrate research findings and as an operational tool to develop strategies of interaction with taxpayers. Next, results on tax decisions and representation of taxation are presented. Finally, methodological caveats are discussed, and conclusions are drawn.

2. TAX BEHAVIOUR RESEARCH

Studies on tax behaviour have identified manifold determinants of compliance. By the late 1970s, the U.S. Internal Revenue Service (IRS) already identified more than 60 factors likely to determine taxpayer behaviour. Yet, important recent additions like gain and loss framing of tax dues and withholding phenomena were not included (IRS, 1978, quoted in Chang & Schulz, 1990). Table 1 shows a list of variables determining tax compliance which have been categorized into variables concerning social representation and decision making, with special attention to self-employed tax behaviour, and interaction style between tax authorities and taxpayers (It should be mentioned here that tax behaviour of self-employed people has received much attention in research but is not explicitly considered in this contribution).

The field has seen several literature reviews (e.g. Andreoni, Erard, & Feinstein, 1998; Brandstätter, 1994; Franzoni, 2000; Hasseldine & Bebbington, 1991; Hasseldine & Li, 1999; Jackson & Milliron, 1986; James & Alley, 2002; Lewis, 1982; Milliron & Toy, 1988; Richardson & Sawyer, 2001; Stenrod, Blumenthal & Christian, 2001; Torgler, 2002; Webley et al., 1991; Weigel, Hensing & Elfvers, 1987), as well as collections of research in taxation such as the annual publication *Advances in Taxation*, edited by Thomas M. Porcano, and, since 2004, Suzanne Luttman, or special journal issues (e.g. *Journal of Economic Psychology*, 1992, edited by Paul Webley and Dick J. Hensing). This accumulated knowledge provides insight into taxpaying behaviour and is of practical relevance for fiscal policy. However, integration into a comprehensive model of taxpayer behaviour is missing. Thus, the fast growing evidence on tax behaviour and the still widely neglected psychological determinants of tax behaviour in economic models call for a review that integrates the most recent findings in social sciences.

Table 1 Classification of determinants of tax compliance

Political perspective (fiscal policy)
Tax system (complexity, tax rates, etc.)
Social psychological perspectives
Mental (social) representations
Tax knowledge and mental concepts
Attitudes: beliefs and evaluations
Norms:
Personal norms: tax ethics
Social norms and identity
Societal norms
Perceived opportunity to evade
Fairness perceptions:
Distributive fairness
Procedural fairness
Retributive fairness
Motivation to comply
Motivational postures
Tax morale
Decision making perspective
Rational decision making
Audit probability, fines, tax rate and income
Psychological aspects of decision making
Sequence of audits; learning processes
Heuristics, biases, frames
Withholding phenomena
Self-employment (paying out of pocket)
Interaction between tax authorities and taxpayers
("Cops against robbers" versus "service for clients" perspective)

Tax behaviour has been investigated from a political perspective, mainly focusing on tax law complexity and shadow economy, and from an economic perspective, with the focus on rational decision-making and the impact of tax audits, fines, tax rates and income on compliance. Tax behaviour research from a behavioural economic and economic psychological perspective has focused on various attitudinal variables, norms and fairness and decision anomalies. Taking all of this into account, the present work classifies this research into two main thematic fields: social representations of taxation and decisions to comply. It is assumed that, depending on the *tax climate*, those variables identified as determinants of tax non-compliance operate differently.

The crucial variable that determines tax climate is assumed to be the way tax authorities interact with taxpayers. Tax authorities who perceive taxpayers as *robbers* rather than *clients* are likely to establish a *command and control* climate with taxpayers engaging in escaping the authorities by taking extensive (rational) decisions. Tax authorities who perceive taxpayers as *clients* and governments committed to responsive regulation are likely to establish a climate of cooperation and trust. In the former case compliance can be enforced if the authorities have the power to control tax behaviour and to fine evasion; in the latter case compliance is expected to be the result of spontaneous cooperation. It is assumed that a *cops against robbers* climate favours selfish decision-making, and that taxpayers who engage in extensive decisions

predominantly consider the probability of detection and fines. Thus, in a *cops against robbers* climate, tax behaviour should depend on audit probability and fines. On the other hand, if the climate favours cooperation, voluntary compliance is expected to depend on the taxpayers' social representations of taxation.

3. INTERACTION BETWEEN TAX AUTHORITIES AND TAXPAYERS

With regard to interaction between taxpayers and tax authorities, two approaches have been distinguished: (a) a *cops against robbers* approach, based on the assumption that taxpayers are unwilling to pay their tax share, and try to avoid taxes legally whenever possible or illegally if it pays; (b) a *service for clients* approach, which assumes taxpayers to be cooperative citizens who are willing to comply if they understand tax laws and perceive the law and the procedures of tax paying to be fair (Kirchler, 2006). We assume that taxpayers react differently depending on the approach taken by the tax authorities. They either comply voluntarily or as the result of enforcement. As long as interaction is based on a positive, trusting foundation, as argued in procedural justice theories (Tyler, 1990), it can be hypothesized that taxpayers are willing to comply voluntarily, without considering what alternative provides the best individual profit. A *cops against robbers* relationship, on the other hand, is likely to provoke more *rational*, selfish behaviour, or at least an attempt to behave rationally in terms of personal profit maximization. When taxpayers start thinking about incentives for evading, they face an explicit decision with the options to comply or to take the risk to evade taxes with the possibility of saving money or, in the case of detection and fines, to lose money. It can be hypothesized that determinants of compliance, collected under the heading *decision-making* or under the title *social representations*, assume different importance. In the case of voluntary compliance, subjective tax knowledge, attitudes, norms and fairness may play a major role, whereas in the case of enforced compliance, audits and fines may prove useful to oblige citizens to pay their share. Before elaborating on which variables might influence tax behaviour under different tax authorities' perspectives and interaction approaches, we will briefly summarize the interaction styles which should be perceived as two end-poles of a continuum.

3.1. *Cops against robbers versus service for clients*

Administration of the tax system is costly and audits are a relevant cost factor. Therefore, effective audit schemes are a necessity, and only those that are efficient in identifying evaders should be applied. Many strategies approach

evasion detection with a *cops against robbers* orientation, with taxpayers as the thieves and tax inspectors as the cops trying to catch them. From such a perspective, it is important to detect individuals with identities and characteristics shrouded in mystery, the so-called *ghosts*; unknown to the tax agency, who is therefore unable to track them down through audit strategies based on reported income. It is also relevant to increase the effectiveness of tax audits by selecting those cases for audits which are most likely to be non-compliant and by awarding a bonus to informants and to tax inspectors. The *cops against robbers* approach is not only costly and of doubtful effect, it also raises the question of how to control the controllers. Moreover, this approach may seem useful in limiting tax evasion by constraining taxpayers to follow the letter of the law, but it is surely not adequate to limit tax avoidance and to motivate taxpayers to voluntarily follow the spirit of the law. Statistics on tax evasion and avoidance leave no doubt that avoidance is by far a greater problem than evasion, so another approach to tax enforcement is clearly necessary.

It is important to take into account that the perception of taxpayers and the resulting style of interaction determine the relationship between tax authorities and taxpayers. From an exchange perspective, the style of interaction determines the *psychological contractual relationship* between the involved parties, which shapes tax morale and consequently willingness to comply. If tax authorities treat taxpayers as fair partners rather than inferior people who are unwilling to pay their share – especially in a relationship where tax authorities have legal power – mutual respect, honesty and trust are likely to be the result.

With the emergence of New Public Management, tax authorities have also become aware of the necessity to consider taxpayers as customers. Instead of using control and unreasonable severity, which provokes a *cops against robbers* mentality, an approach characterized by education and support is more promising in the endeavour to persuade taxpayers to comply. Tax authorities of various countries are redesigning their approaches to taxpayers by treating them as clients and addressing their needs and improving fiscal consciousness. James, Hasseldine, Hite and Toumi (2003) report strategies to promote voluntary compliance, including: training of tax officers; improved public relations; simplification of tax laws and procedural fairness; organizational improvement to facilitate taxpayers' consultation, resolve problems at a single point of contact, and assist in taxpayer compliance; and improving citizens' awareness with regard to their tax responsibilities.

In 1992, Ayres and Braithwaite proposed a new approach to ensure business compliance with regulatory rules. Their approach of responsive regulation is presented in the form of a pyramid with cooperative strategies of self-regulation at the bottom and severe sanctions and incapacitating of wrongdoing

ing at the top. The model recognizes that legal sanctions are not sufficient to enforce compliance. It rather focuses on education, persuasion and dialogue as strategies to gain and maintain compliance of most taxpayers. However, in the case of voluntary and repeated non-cooperation, severe economic and legal sanctions come into operation.

Introducing a new approach is not easy and resistance to change in organizations is likely to result. The proposed new culture of a customer relations orientation is, however, more promising in enhancing cooperation, creating a cooperative tax climate and increasing voluntary compliance than the traditional perception of taxpayers as egoistic utility abusers.

Tax authorities who adopt a *cops against robbers* perspective, who exert sharp undifferentiated control, and who apply severe punishment in cases of filing mistakes and evasion, are likely to contribute to the creation of a climate in which taxpayers are perceived as *enemies* whose illegal behaviour requires prosecution. On the other hand, taxpayers may themselves assume the role of the hunted. Rather than looking at tax authorities as accomplishing a relevant task for the welfare of the community, they may perceive them as hunters, whom taxpayers want to escape from. Perceived peril of prosecution and prosecution is likely to corrupt taxpayers' willingness to comply voluntarily. Rather than perceiving interaction processes with the authorities as supportive and fair, and authorities as trustworthy, taxpayers may consider possibilities to legally avoid paying taxes, or, if it pays, to evade. It might be assumed that under these circumstances, taxpayers try to make a (rational) decision and will choose the option that promises the highest individual profit, rather than considering their tax share as a fair contribution to the public good. If this assumption is correct, tax behaviour can best be explained as the outcome of a decision process. Variables described in the decision-making chapter below may best describe compliance, whereas social norms and fairness judgments may serve as arguments for rationalizing ones behaviour rather than determining ones behaviour. Indeed, it is not voluntary cooperation that requires audits and punishment, but rather endeavours of individual profit maximization. Tax policy must consider when and how often to control taxpayers, and how to frame taxes in order to reduce taxpayers' perception of loss and reluctance to pay their share. While a *cops against robbers* climate might make the losses from paying taxes more salient, evoking thoughts on possible gains from evasion and a (rational) decision on these two prospects, a *service for clients* approach emphasizes the gains from paying taxes for the collective as a whole. Moreover, the latter establishes a relationship built on trust and cooperation, which leads to voluntary cooperation. The change of focus from the individual to collective welfare makes egoistic utility maximizing less likely. A *service for clients* atmosphere may be based on and lead to completely different attitudes of taxpayers. Taxpayers

should be cooperative and willing to comply, as directed by their (social) representations of the government and of taxation: when the tax law is clearly understandable to be followed correctly, when the government policy meets citizens' acceptance, when tax mentality is positive, when personal and social norms favour cooperation, and when distribution of taxes is perceived to be fair and procedures are just, then taxpayers should be motivated to pay taxes correctly. Compliance due to fair treatment of taxpayers and a trusting climate in general may, in turn, stabilize favourable (social) representations and stabilize voluntary compliance. It should be mentioned that rational choices are not necessarily associated with an antagonistic climate only. Also in a cooperating climate, taxpayers can engage in extensive decision-making and their behaviour can be described as rational if besides short-term (possible) financial gains and losses the value of a trustworthy, friendly and cooperative climate is considered as well as a decision criterion. Voluntary compliance should depend and be based on those variables summarized under *social representations*. If taxpayers are treated as equal partners, if they understand tax law and agree with the government activities in general and with fiscal policy in particular, if taxes are perceived as fair and tax collection procedures are transparent and perceived as just, it can be assumed that taxpayers behave as cooperative citizens, and intrusive audits and severe punishments in case of unintentional filing errors would undermine their voluntary cooperation instead of stimulating them to file correctly. Indeed, it is assumed that a *cops against robbers* perspective can easily destabilize and corrupt a climate characterized by trust and cooperation.

3.2. Trust and voluntary compliance versus enforced compliance

Tax authorities' orientation towards taxpayers and their interaction style create a tax climate which either favours taxpayers' cooperation and voluntary compliance or fosters resistance and individual profit maximization. Where-as a *cops against robbers* approach stimulates a climate of persecution and prosecution, and consequently one of unwillingness to cooperate and individual profit considerations, a *service for clients* approach seems likely to stimulate a climate of cooperation. Interaction processes based on transparency and neutrality of the procedures, trustworthiness of tax institutions and tax authorities, and respectful, polite and dignified treatment of taxpayers are likely to enhance voluntary compliance. Voluntary compliance is assumed to be related to taxpayers' social representations in particular. A climate of cooperation is likely if government policy is accepted, personal and social norms are favourable to cooperation and tax burden and tax procedures are perceived as fair.

If the climate is hostile, compliance can be enforced if government institutions, such as tax authorities, have the power to enforce compliance. Taxpayers who are unwilling to pay their taxes, but are threatened by audits and fines, need to carefully consider what option to choose: the safe option to pay their tax share, accepting the loss of some money, or the risky option with the possibility of saving on taxes or being detected and fined. Under such circumstances, extensive decision-making processes are likely to occur, with taxpayers carefully considering the value of their options. Audit probability, fines, tax rates, income effects, strategies assumed to be applied by tax authorities and chances to escape them, framing effects and withholding phenomena, etc., are likely to be meticulously considered in deciding how to deal with one's income and with tax authorities. People with many opportunities to evade or to avoid their taxes are likely to cut their share if it pays, that is, if the power of tax authorities is weak. In the case of strong power to enforce tax payments, that is, high audit rates, high detection probability and severe fines, and unequivocal tax laws forbidding tax avoidance, taxpayers are constrained to comply. It can be expected that the weights of determinants of compliance differ depending on tax climate. Hence, empirical studies should reveal different determinants in operating depending on the predominate climate of the society or laboratory environment. This would explain why empirical studies sometimes confirm a strong deterring effect of audits and fines, while these effects are low or even reversed in other circumstances (Andreoni et al., 1998).

If the climate is friendly and taxpayers trust the authorities, compliance is likely to occur voluntarily, independent of tax authorities' power. Taxpayers may perceive paying taxes as a civil duty and cooperate with government institutions to the benefit of the community. In a climate of mutual trust, audits and sanctions are likely to have no effect or they can even corrupt cooperation. A *service for clients* approach is characterized by clear and understandable regulations, transparency of procedures, neutrality, respect and politeness with regard to taxpayer treatment as well as support. Rather than deciding what option promises the highest individual profit, subjective understanding of tax law, attitudes towards the government, personal and social norms, perceptions of distributive fairness and procedural justice are likely to affect taxpayers' motivation to meet tax requirements. On the aggregate level, high tax morale and a strong sense of civic duty ensure citizens' willingness to cooperate with the state voluntarily.

Figure 1 displays these assumptions graphically in a three-dimensional space with the power of authorities to control and to fine taxpayers, trust in authorities, and compliance as dimensions. It is assumed that compliance can result under the condition of strong power of the state as well as under the condition of trust in authorities. On one hand, if tax authorities have the

power to enforce compliance and if taxpayers, deciding how to increase their individual profit, come to the conclusion that it does not pay to evade, enforced compliance is high. If trust in authorities is low and if power of authorities is weak, it is likely that citizens seek opportunities to avoid or evade taxes. On the other hand, voluntary compliance is high if interaction with authorities is trustful and if citizens understand the law and perceive taxes as distributed fairly and procedures as just, if they hold positive attitudes towards the government and have developed favourable personal and social norms, that is, they have favourable social representations about taxation. The power of the state, expressed by audit frequency and the power to sanction non-cooperation, is ineffectual if trust is high.

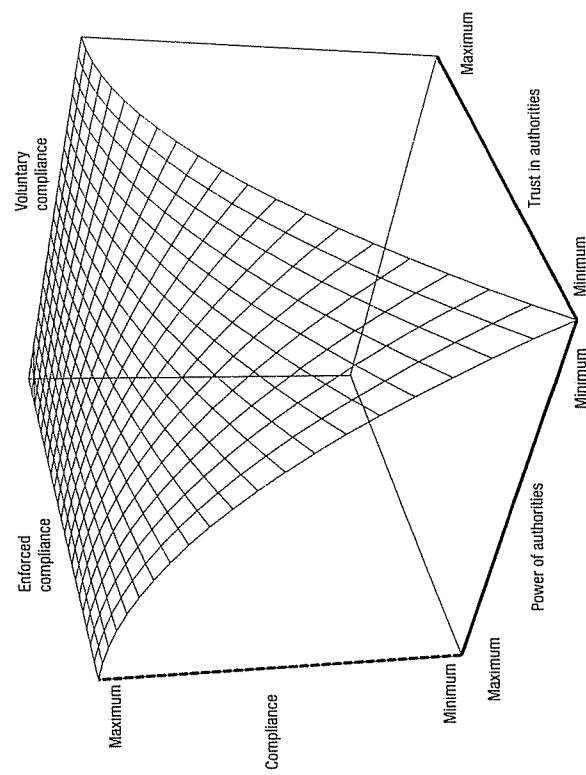


Figure 1 Enforced compliance versus voluntary compliance depending on the power of the state and trust in the authorities.

The model presented in Figure 1 can be used both as a conceptual tool and as an operational tool. As a conceptual tool it may serve to understand the importance of determinants of tax behaviour and the ambivalent effects imported in empirical research. In other words, it is expected that variables considered in decision-making approaches operate best if the tax climate is rather antagonistic, whereas variables considered in studies on social representations operate if the climate is characterized by trust. As an operational tool, the model can be used to develop strategies of effectual interaction between tax authorities and taxpayers. In a climate of distrust however,

taxpayers do find audits to be a negative experience, but the impact of this experience is to make them want to evade by more in the future in an attempt to "get back" at the tax agency' (Andreoni et al., p. 844).

With regard to fines, theoretical economic analyses of the effect of audits and fines suggest unequivocally a positive relationship between audit probability and fines on evasion. The empirical research, on the other hand, did not create a clear picture of the results. Fischer et al. (1992) conclude their review on the experimental literature on the relationship between audit and detection probabilities and taxpayer compliance by emphasizing the inconsistency of findings: some experiments failed to detect a significant positive relationship, other studies, attempting to determine the relative effectiveness of increased detection probability versus fines, provide weak evidence that fines are more effective, but other studies conclude that detection probability is more effective. Despite mixed results, the most common results seem to suggest a positive relationship between detection probability and compliance.

There are many reasons that can explain why probability of audits and fines do not have the predicted large effect on tax compliance. First of all, the assumption that taxpayers are trying to avoid taxes whenever it pays must be doubted, especially if taxpayers trust the government and tax authorities, and if the tax climate is favourable. Many studies show that a vast majority of citizens are willing to pay taxes and do not seem to undertake economic decisions under uncertainty in order to maximize income. Most taxpayers seem to take the legitimacy of the tax system and its overarching objectives for granted, and are probably not engaged in decision-making if the tax climate is characterized by mutual trust, but pay their share without considering possibilities to avoid or to evade taxes.

Rational models of decision-making assume perfect information processing. However, studies in behavioural economics, economic psychology and cognitive psychology present convincing evidence that the information processing capabilities of individuals are limited. The more complex a situation is, the more decision makers deviate from what the rational model predicts and the more inconsistent decisions are likely to be. People use heuristics and are vulnerable to biases. Due to limited understanding of tax issues and lack of interest in the issue, individuals were sometimes found to be inconsistent with regard to their preferences for specific types of tax, i.e., regressive, flat or progressive tax systems. Depending on the metric, individuals seem to prefer progressive tax if their judgments are based on probabilities, but they like flat tax in situations where tax is presented in absolute amounts of money.

Most research on decision-making biases is related to the prospect theory, and the tendency to seek risk in situations in which one loses and to avoid risk in situations in which one gains. If taxpayers pay a lump sum of income

authorities need to exert audits and fines to enforce compliance, strategies leading to favourable social representations and trust may favour voluntary compliance. In the case of high trust, *cops against robbers* strategies may not only be ineffectual but may even corrupt the cooperative climate.

3.3. *Distrusting climate and the importance of profit maximization*

If the tax climate is perceived as non-cooperative and if taxes are not paid voluntarily, taxpayers are likely to face a social dilemma situation. The optimal strategy for rational individuals is to evade. Such rational behaviour leads to the worst outcome for the commons and ultimately for each individual. Therefore, taxpayers need to be forced to cooperate by control mechanisms and severe fines in case of non-cooperation. The neoclassical economic approach to tax behaviour starts from this assumption. In their seminal works, Allingham and Sandmo (1972) and Srinivasan (1973) start with the assumption that taxpayers can choose between two main strategies: (a) a taxpayer may declare the actual income, or (b) declare less than the actual income. When deciding the latter strategy, the payoff will depend on whether or not the taxpayer is investigated by the tax authorities. If taxpayers are not investigated, they are clearly better off than under the first strategy. If they are investigated and evasion is detected, they are worse off. Taxpayers are assumed to engage in maximizing income by making a decision under uncertainty. Audits and sanctions in cases of evasion are perceived as the dominant instruments to ensure cooperative behaviour.

Studies on the impact of audits on compliance found that they are not strongly related. With regard to objective audit probabilities and subjectively perceived probabilities, Andreoni and colleagues conclude their 1998 review stating that audit probabilities have little effect on compliance and perhaps the effect of subjective audit and detection probabilities is mediated via psychological variables, such as moral obligations. The studies discussed ... indicate that individuals generally make poor predictions of the probability of audit and magnitude of fines from tax evasion. Moreover, there is consistency between their sense of a moral obligation to be honest and the tendency to overestimate the chance of being caught. Perhaps as a consequence, a high subjective probability of detection is associated with significantly more compliant behaviour' (p. 846).

The authors conclude their discussion on prior audits by emphasizing the importance of considering why audits have very little specific deterrent value: 'One possible explanation is that audits may not turn out as badly as taxpayers initially fear. For example, if an audit fails to uncover existing non-compliance or if a substantial penalty is not applied to discovered non-compliance, a taxpayer may conclude that it pays to cheat. Alternatively, perhaps

tax when filing their taxes, they have either paid too much or not enough and either a refund or a balance will be due. Those taxpayers who have a refund seem to perceive their tax refund as a gain, whereas those whose tax liability actually paid is lower than the liability determined by the tax office (and thus owe an additional tax payment), seem to perceive the taxes due as a loss and try to repair it by not reporting income or by overstating expenditures. Studies on advance tax payments and refunds or additional taxes due at the time of tax reporting, show that compliance is more likely to occur and involves larger amounts of money among participants who are confronted with the prospect of a tax refund. Also, in the case that withholding leads to a tax refund at the end of the year, fairness judgments are more favourable.

Prospect theory seems to be able to explain, at least in part, decisions to comply or not to comply in view of a taxpayer's current cash position and expected payments or refunds due. However, the impact of current cash position and expected outcomes on tax decisions is complex and seems to vary between taxpayer groups, depending on their experiences. Moreover, predictions of prospect theory and framing effects differ with regard to taxpayers' tax ethics. Taxpayers who strongly agree that tax evasion is morally wrong seem not to be influenced by the withholding frame, while those with low tax ethics may not declare the full income when additional taxes are due at filing (e.g., Cox & Plumley, 1988; Webley et al., 1991).

3.4. *Trusting climate and the importance of social representations*

Individual and social representations of taxation refer to the knowledge, thoughts and beliefs, feelings and evaluations, norms, fairness perceptions, motivational tendencies and, in general, citizens' tax morale. Although empirical studies lack findings of a strong relationship between individual and social representations and tax behaviour, we do not doubt Schmolders's 1960 claim that '... the state is mirrored in citizens' minds', an idea key to understanding what citizens approve and disapprove of in tax politics and which arguments lead to acceptance of tax non-compliance, to acceptance of noncooperation between citizens and the community, and opposition to prosecution of evasion. In everyday life taxes might not be a hotly disputed issue. Nevertheless, people periodically try to make sense of their contributions to the community, namely when taxes are due, when government spending is contested or when new taxes are introduced. Moreover, the public discussion of taxation issues leads individuals to evaluate fiscal policy, tax rates and the use of taxes for the provision of public goods, as well as the interaction between themselves as taxpayers and tax authorities. Eventually, motivation to comply or not to comply develops and respective behaviour follows.

Tax law is complex. Most people are neither interested in nor do they have a proper understanding of the law. They often only have vague ideas about the taxes they pay. Poor understanding or misunderstanding breeds distrust and opposition. Traditional assumptions link low tax knowledge with non-compliance. It was, however, also argued that lack of knowledge leads to uncertainty and people's risk aversion may increase in situations of uncertainty. Indeed, Beck, Davis and Jung (1991) found that income uncertainty can increase reported income. Snow and Warren (2005) showed that an increase in taxpayer uncertainty about the amount of tax evasion an audit can detect, increases compliance of prudent taxpayers. Caballe and Panades (2005) conclude that effects of uncertainty about audit costs are generally ambiguous. Nevertheless, it can be generalized that most survey studies confirmed a positive relationship between tax knowledge, subjective understanding and tax attitudes.

People's attitudes, judgments and behaviour intentions are more affected by what they think than what actually is (Lewis, 1978). Since tax laws are criticized as being too complex to be fully understood by ordinary taxpayers, representations and evaluations of taxes are mainly a product of myth. Unsurprisingly, associations with taxes are often negative. However, representations about taxation are different in different taxpayer groups: while most people recognize the need for contributing to the public budget and are aware of public goods, taxes are either perceived as a loss of personal freedom to decide how to invest one's own money, as contributions without a fair return, or as a repeated request by the government to plug the gaps in the state's finances which are caused by inefficient management by politicians.

Studies on tax psychology often focus on attitudes and tax compliance. Within the frame of the theory of planned behaviour (Fishbein & Ajzen, 1975) and the theory of reasoned action (Ajzen, 1991), attitudes are – among norms and perceived control of behaviour or perceived opportunities of avoidance – determinants of intentions of behaviour. Often attitudes towards tax evasion are quite positive. People avoiding their tax payments were frequently judged rather positively, as quite intelligent and hard working. This result is not surprising, since work and achievement are fundamental values in societies with Christian tradition and wealth is perceived as a consequence of hard work and discipline. Some types of shadow work might be perceived as a virtue rather than a vice, especially if it is hard work, and keeping what one has earned may not be judged as criminal behaviour. On the other hand, taking advantage of public goods to which one is not entitled is condemned and judged as incorrect.

Besides attitudes as combined beliefs about an entity and evaluations of these beliefs, norms and control determine behaviour intentions. Like attitudes, norms have received considerable attention in tax research. However,

vided a conceptual framework for justice and fairness considerations based on conceptual distinctions made in social psychological justice research. In social psychology, three areas of justice are differentiated: (a) distributive justice refers to the exchange of resources, both benefits and costs, (b) procedural justice refers to the processes of resource distribution, and (c) retributive justice refers to perceived appropriateness of sanctions in cases of norm breaking. The central questions refer to attributions of responsibility to wrongdoers, the restoration of damages of wrong behaviour and the punishment a norm-breaker deserves.

With regard to distributive justice, comparisons are made on different levels. At an individual level, research on horizontal fairness considers the distribution of resources between taxpayers of comparable income groups. If an individual's perceived tax burden is heavier than that of comparable others, tax evasion is likely to increase. Besides horizontal fairness, vertical fairness and exchange fairness are of taxpayers' major concern. If taxpayers disapprove of government spending and perceive the exchange with the government as unjust, tax evasion is likely to increase. At the societal level, taxpayers may evaluate the fairness of the tax system. There is evidence that suggests that the structure of taxes has an influence on people's willingness to comply. On the societal level, especially questions regarding progressive, regressive or flat tax are important.

In tax research, procedural justice is of inestimable importance. On the individual level, procedural justice refers to the quality of treatment in interaction between taxpayers and authorities, the degree of quality of information provided by tax authorities, and to compliance and administration costs as well as dynamics of allocation of revenues. Access to and provision of information related to the tax law and explanations for a tax law change can increase fairness perceptions. It seems that information which reduces the complexity of the tax law and makes it more accessible leads to perceptions of greater fairness. Efficiency of interactions between taxpayers and tax authorities, length of queues at information desks, and satisfaction with audit treatment all seem to determine perceptions of procedural justice. At the individual level, fair treatment of individual taxpayers and the culture of interaction are relevant aspects of the perceptions of fairness and justice and creating a trustworthy relationship. On the group and societal level, procedural fairness concerns the neutrality of tax officers regarding cohorts such as occupational groups or income groups. The perception that certain groups of people have more liberty leads to the perception of unfair treatment. If tax authorities and officers treat taxpayers equally, in a respectful and responsible way, trust in the institution and cooperation is likely to increase on individual, group and societal levels. Tax non-compliance can be the result of disapproval of government policy. Experimental work by Alm, Jackson and

the conceptualization and use of norms as predictors of tax compliance is mixed. There is considerable overlap between perceived personal norms, values and a person's tax ethics, defined as the belief that there is a moral imperative that one should deliberately comply, and social norms, usually defined as prevalence or acceptance of tax evasion among a reference group (Wenzel, 2005). Personal norms reflect a taxpayer's tax ethics and are related to moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency and values. If someone's moral conscience is more developed, he is more honest and less egoistical or Machiavellian. His social values will be more pronounced and harmonious, the religious beliefs will be stronger, and therefore he is more likely to feel shame and guilt when misbehaving, and is more likely to comply with the law.

Social norms are a function of an individual's perceived expectation that one or more relevant referents would approve of a particular behaviour and the extent to which the individual will be motivated to comply with such a referent's beliefs. The relevance of social norms is generally supported in empirical studies on tax evasion. If taxpayers believe that non-compliance is widespread and socially accepted behaviour, then it is more likely that they too will not comply. The relationship between social norms and tax compliance intentions is complex, however. Wenzel (2004) argues that social norms should elicit concurring behaviour when taxpayers identify with the group to whom the norms are ascribed. Taxpayers then internalize the social norms and act accordingly. However, when identification is weak, social norms are ineffective or even counterproductive.

Norms are conceived as behaviour standards on three levels: the individual, social reference group, and national level. On the individual level, norms define internalized standards on how to behave; in one's social setting, norms determine the behaviour of a social group, e.g. friends, acquaintances or vocational group. Finally, on the national level, norms become cultural standards, often mirrored in the actual law. Research on tax compliance has focused on personal ethics and subjective perception of behavioural habits in taxpayers' reference groups. On the cultural level, norms have been addressed mainly under the terms tax morale (Schmolders, 1960) and civic duty (Frey, 1997), and also under the term cultural norms. Also, cultural norms and societal institutions are perceived as important in determining tax compliance.

When citizens are asked what they think about the tax system, most often fairness concerns are communicated. Consequently, Andreoni et al. (1998) claim that incorporating morals and social dynamics in economic theory is essential. The most frequent differentiation in tax compliance research referred to exchange equity with the government and to equity of one's contributions relative to the contributions of other taxpayers. Wenzel (2003) pro-

whereas at the national level, tax morale and civic duty are the motivational forces leading to or deterring from engagement in the shadow economy, tax evasion and avoidance.

The integration of taxpayers' beliefs and evaluations as well as expectations relative to the tax authority, their actions in response to their beliefs, evaluations and expectations are labelled *motivational postures*. Motivational postures determine the way taxpayers position themselves in relation to tax authorities. They determine cooperation and non-compliance and justification processes. Five motivational postures were identified (V. Braithwaite, 2003; V. Braithwaite, J. Braithwaite, Gibson & Makkai, 1994). Commitment and capitulation reflect an overall positive orientation towards tax authorities, whereas resistance, disengagement and game playing reflect a negative orientation. V. Braithwaite (2003) found that different motivational postures can be held simultaneously, they are not stable individual characteristics, allowing taxpayers to shift between them. Commitment and capitulation were the most frequent motivational postures in surveys conducted in Australia. Resistance, game playing, and disengagement were found less frequently. Moreover, commitment and capitulation were negatively related to evasion and tax avoidance, whereas the other three postures were positively related.

On the aggregate societal level, tax knowledge, attitudes, norms, perceived opportunity, fairness considerations and motivational postures are forming tax morale. Tax morale implies the intrinsic motivation to comply. The term *tax morale* was coined in 1960 by Schmolders, who defined it as '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 acknowledgment of the sovereignty of the state' (pp. 97f). The importance of tax morale and its impact on shadow economy in general and tax non-compliance in particular has been widely supported by empirical research (Alm & Torgler, 2006).

3.5. Methodological caveats

We started from the fact that results in tax research are heterogeneous. This is not only due to different approaches of *cops against robbers* or *service for clients*, or simply due to the fact that tax evasion is difficult to measure because 'individuals often undertake substantial efforts to conceal their evasion' (Andreoni et al., 1998, p. 836), but also has a methodological aspect.

Results depend on the definitions of the concepts, the way ideas are made operational and the methods that are applied. Not surprisingly, the arsenal of methods, sampling techniques, getting the variables to work and the differ-

McKee (1990) also provides similar evidence: tax compliance tends to be higher when taxpayers are aware of a direct link between their tax payments and the provision of a desirable public good. Considerable sociological work suggests that taxpayers are more likely to report honestly if they feel that they are being treated courteously and respectfully by the tax agency. Consistent with this perspective, Frey (1992) argued that tight monitoring and heavy punishment on non-compliant citizens can crowd out tax morale and ultimately result in greater non-compliance.

Similar to procedural justice, retributive justice has rarely been investigated in the field of tax compliance. Moreover, retributive justice is closely related to the interaction between tax authorities and taxpayers as well as to procedural justice. Retributive justice regards the rigidity of audits and the responsibility for wrongdoing, the restoration process and appropriateness of penalties in case of norm breaking. Unreasonable and intrusive audits and unfair penalties lead to negative attitudes toward the tax office and taxes in general. Also, tax amnesties are an issue of retributive justice, if amnesties are perceived as legalising illegal behaviour and favouring the wealthy who resisted compliance.

Justice research has not always yielded consistent evidence for the impact of justice perceptions on tax compliance. The cause is mainly that different aspects of justice and fairness were investigated; making justice operational and the measurement of justice are heterogeneous and inter-individual while situational differences, such as the tax climate, were largely neglected. As Wenzel (2002) shows, fairness judgments are not stable but depend on the object of comparison and on taxpayers' identification with a social group or category to which justice refers. Justice concerns seem to be especially strong if taxpayers identify with their nation and the tax collecting government.

Subjective construction of tax phenomena and collective sense making are based on subjective tax knowledge, myths and legends, on subjective constructs and evaluations in terms of attitudes, on perceived and internalized norms, perceived opportunities not to comply, and on fairness perceptions. The condensation of knowledge, attitudes, norms, opportunities and fairness considerations yields the motivation and drive of taxpayers to behave honestly. V. Braithwaite (2003) refers to the aggregation of subjective constructs and socially shared beliefs and evaluations as motivational postures. The concept of motivational postures as *interconnected beliefs and attitudes that are consciously held and openly shared with others* includes individuals' attitudes toward the government, the tax system, other taxpayers, and individual and social norms (V. Braithwaite, 2003). On the level of the society and nation, the aggregate of citizens' beliefs and evaluations of the state, taxation, and non-compliance yield tax morale and civic duty. On the individual level, motivational postures are the driving factor of compliance and non-compliance,

Problems of measurement originate from different sources. First, it is not always clear what is understood as non-compliance, evasion or avoidance. While non-compliance represents the most inclusive conceptualization and refers to the failure to meet tax obligations whether or not that failure is intentional, evasion and cheating refer to a deliberate act of non-compliance that results in the payment of fewer taxes than actually owed, whether or not the behaviour eventuates in subsequent conviction for tax fraud. Secondly, tax officials may not always be able to correctly detect intentional and unintentional acts and, thus, be unable to distinguish between fraud and taxpayers' errors. In the third place, variables that influence intentional evasion behaviour may be quite irrelevant for explaining inadvertent non-compliance, and with respect to income taxes, evasion in the form of deliberately underreporting income may depend on variables different from those that determine unwarranted deductions being claimed.

In economics, experiments increasingly become accepted methods to test theoretical predictions in a controlled field (Davis & Holt, 1993). From these experiments, causality conclusions are drawn. Experimental approaches have often been criticized as lacking validity. With regard to internal validity, inferences about a causal relationship between independent and dependent variables must be accurate; investigated higher-order constructs must be made operational appropriately so that they are reflected in the experimental treatments; and external validity, that is, the generalisation of causal relationships, must be assured (Fischer et al., 1992).

Besides methodological concerns, it should be noted that most findings originate from studies that were conducted in the US, which limits the generalisation of results. Few studies focus on cultural differences and differences between tax systems have rarely been addressed. As we have argued above, the tax climate as transmitted through the tax system and the demeanour of tax authorities could be an important factor for tax compliance.

4. CONCLUSIONS

Several countries (e.g. Austria, Australia, France) have put particular effort in simplifying tax law for the self-employed and small business owners, and in establishing a *service for clients* approach. With the emergence of New Public Management (Andrews, 2003; Gruening, 2001; Horton, 2003), tax authorities have become aware of the necessity to consider taxpayers as customers. Instead of control and unreasonable severity, an approach leading to a *cops against robbers* mentality, an approach characterized by education and support is more promising in the endeavour to persuade taxpayers to comply with the spirit of the law. Tax advisors and tax officers play a key role in

ences between self-reported and observed tax non-compliance have been discussed extensively (e.g., Fischer, Wartick & Mark, 1992; Groenland, 1992; Torgler, 2002; Webley, Robben, Elffers & Helsing, 1991). In their review of the literature on detection probability and compliance, Fischer et al. (1992) summarise insights stemming from analytic studies in the field of microeconomic decision theory, which develop mathematical models of tax evasion, predominantly examining the impact of audit probability, fines in cases of evasion, tax rate and income. The models are highly stylised analyses that neglect many facets of taxpayers' realities. Although mathematical models provide valuable insights in compliance behaviour and may be highly sophisticated, they reduce taxpayers to people who are motivated solely by financial profit. The difficulty of obtaining *hard* empirical data on tax compliance has led researchers to collect data via surveys and experimental simulation (Baldry, 1987). Economic psychological approaches particularly rely on surveys. In surveys, taxpayers are asked to self-report their evasion activities. Although surveys are usually an economical way of collecting data, they have several shortcomings which limit the generalization of findings (e.g. Wilson & Sheffrin, 2005). Reliability and validity of measures, especially construct validity, constitute major problems with the approach. Helsing, Kinsey, Elffers & Weigel (1988) explored the limitations of self-reports as substitutes for observation of tax evasion behaviour and found negligible correspondence between respondents' self-reports of tax evasion and officially documented behaviour. Insignificant correlations were obtained despite the fact that all government claims against the respondents had been settled, without protest, before the study began and despite the respondents' awareness that the accuracy of their self-reports could be checked against their tax records. The results of the study suggest that different explanatory variables may be correlated with each type of behavioural measure: attitudes toward the tax non-compliance measures and subjective norm measures exhibited significant correlations with the self-report data but not with officially documented behaviour, and measures of more broadly focused personal dispositions predicted actual behaviour but not self-reports.

Having observed a lack of association between self-reported evasion behaviour and officers' classifications, Elffers, Weigel and Helsing (1987) studied data generated from self-reports, tax officers' classifications and experimental methods on the same sample of taxpayers. Not only was the lack of association between self-reported behaviour and officers' classifications replicated, but also the evasion in the experiment did not correlate with either. The authors conclude that tax evasion consists of at least three conceptually independent aspects that need to be assessed by three independent measures, which leads to the conclusion that self-reported tax evasion is not a proxy of observed evasion.

securing overall compliance. Should they develop an adversarial relationship through a *cops against robbers* mentality, characterized by poor communication skills, lack of technical and legal knowledge, and inconsistency in punishment, current and future tax compliance may decrease (Hansford & Hasseldine, 2002).

We developed a model based on the assumption that a *cops against robbers* climate favours taxpayers' engagement in (rational) decision-making, aiming at maximizing their individual profit. Under such circumstances we further assume that audit rate, fines and the marginal tax rate are relevant variables that determine (enforced) compliance. If the climate favours mutual cooperation, voluntary compliance is likely to be the result. Voluntary compliance is assumed to depend on taxpayers' social representation of taxation. Subjective knowledge, attitudes, personal, social and societal norms, and fairness perceptions are likely to determine motivation to comply at the individual level, and high tax morale at the aggregate national level. At present, the tax compliance model is based on theoretical reflections. Further research may show whether it holds its promises to serve as a conceptual tool for integrating the manifold findings in tax research, and as an operational tool to develop strategies which enforce and stabilize a trustworthy tax climate which favours voluntary compliance.

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