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## 16 Tax behaviour

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### LEARNING OUTCOMES

#### BY THE END OF THIS CHAPTER YOU SHOULD BE ABLE TO:

1. Describe psychological explanations of the behaviour of individual taxpayers and companies.
2. Discuss the relationship between taxpayers and tax authorities with respect to interaction climates, trust, and power.
3. Give examples of regulation strategies and practical implications.

## 16.1 INTRODUCTION

The aim of this chapter is to introduce psychological perspectives on tax behaviour. Taxpaying and tax evasion are important economic behaviours that concern citizens, companies and governments. Because taxpaying can be viewed as a social dilemma, individual attempts to evade taxes have negative effects on the community and in consequence again on the individual. On the one hand, it is important to understand what influences tax behaviour. Factors range from audits and fines to attitudes towards taxes and tax evasion, social norms and justice. On the other hand, it is important to understand how tax behaviour can be regulated. Approaches range from command-and-control strategies to responsive strategies. This chapter proposes that the interaction climate between taxpayers and tax authorities matters, and that the coordination of power and trust into a comprehensive approach to understanding and regulating tax behaviour is key.

## 16.2 TAXES AND TAX COMPLIANCE

From the perspective of governments, taxes are used to fund public goods, to influence markets, and to regulate the behaviour of citizens and companies. Taxes can be an instrument to shape behaviour by providing incentives (e.g., to consume healthy food and engage in environmentally-friendly activities) or by increasing costs to control undesirable behaviour (e.g., smoking and excessive consumption of energy; Freiberg, 2010). Moreover, taxes are a policy instrument applied to redistribute wealth across society. A progressive tax system can reduce the unequal distribution of wealth and has been found to be positively related to social well-being at the aggregate national level (Oishi, Schimmack, & Diener, 2012). Governments pass tax laws, and tax compliance refers to the degree to which citizens and companies follow these laws.

From the perspective of taxpayers, taxes are often seen as a burden which citizens and companies try to avoid (Kirchler, 2007). Consequently, the classical economic approach to regulate tax behaviour was auditing and imposing sanctions on illegal actions (Allingham & Sandmo, 1972; Srinivasan, 1973) to ensure tax compliance. Tax evasion, i.e., illegal methods to reduce the tax burden, can to some extent be influenced by such command-and-control approaches (Slemrod, Blumenthal, & Christian, 2001). However, many studies have shown that the effect is rather weak (e.g., Andreoni, Erard, & Feinstein, 1998). These studies suggest that audits and fines explain only part of tax behaviour and are without effect on tax avoidance, i.e., legal methods to reduce the tax burden such as exploiting loopholes in the tax law.

Economic psychology acknowledges that tax behaviour depends partly on audits and fines. However, to understand the motives for tax compliance it is necessary to understand taxpayers' attitudes towards taxes, their knowledge and understanding of tax laws, their personal and social norms, and fairness concerns related to distributive and procedural justice. Alm, Kirchler and Muehlbacher (2012) summarized the determinants of compliance as studied by economists and psychologists. Besides socio-demographic characteristics, the effects of audits and fines, marginal tax rate, income level, opportunities to evade by various occupational groups, complexity of

the tax law, attitudes and tax morale, personal, social and societal norms, and the complex facets of distributive, procedural and retributive justice were investigated (see also Kirchler, 2007; Pickhardt & Prinz, 2014). Table 16.1 provides an overview of determinants of tax compliance in the form of broad generalizations.

The following sections will focus on selected topics on the levels of individual taxpayers, companies, and tax authorities. An integrative view on the interaction climate between taxpayers and tax authorities is introduced. The chapter ends with practical implications to increase tax compliance.

**Table 16.1** *Economic and psychological determinants of tax compliance*

<b>Determinants</b>	<b>Effect</b>
<b>Economic determinants</b>	
Audits	Higher probability of audits increases compliance, but subjective probability appears to have a larger impact than objective probability
Fines	High fines increase compliance, but need to be in line with retributive justice
Marginal tax rate	Tax rate effects on compliance are mixed
Income size	Income effects on compliance are mixed
Opportunity to avoid or to evade taxes	Higher opportunities to avoid or to evade taxes reduce compliance
<b>Psychological determinants</b>	
Complexity of tax law	High complexity and subjective incompetence reduce compliance
Attitudes	Viewing tax evasion as only a minor crime and negative attitudes towards taxes and tax authorities reduce compliance
Personal norms	Internalized ethical values and the personal tendency to obey laws increase compliance
Social and societal norms	Ethical values of the social group and of a society as a whole increase compliance
Distributive justice	High fairness in terms of horizontal fairness (an individual's tax burden in comparison to others), vertical fairness (individual tax burden in comparison to those capable of contributing more or less) and exchange fairness (tax burden relative to the provision of public goods financed by tax revenues) increases compliance
Procedural justice	High fairness of tax-related decision-making procedures (e.g., having a voice in policy making, transparency) increases compliance
Retributive justice	High fairness of the form and severity of the punishment imposed on tax offenders increases compliance

Source: Adapted from Alm, Kirchler and Muehlbacher (2012, p. 138), with permission from Elsevier B.V.

## 16.3 TAX ATTITUDES BY INDIVIDUAL TAXPAYERS

### 16.3.1 *Tax Laws and Tax Evasion*

Tax law is extraordinarily complex. Not surprisingly, then, the majority of taxpaying citizens have difficulties in understanding what is right and what is wrong. Even tax authorities and tax advisors express difficulties in drawing a clear borderline between what is legally right and what is wrong. This is a long-standing problem. More than half a century ago, Schmolders (1959) found that politicians in the German parliament and members of its finance committee had a poor understanding of fiscal policy. In the meantime, the tax code of many countries has become even more complex. Owens and Hamilton (2004) reported that the entire tax code of the Internal Revenue Service in the United States quadrupled in number of words from 1955 to 2000. People blame the complexity of tax law for their feelings of tax incompetence and lack of interest in the system (McKerchar, 2001) and feel it is necessary to consult tax practitioners (Sakurai & Braithwaite, 2003). Niemirowski and Wearing (2003) found a high level of agreement among taxpayers with the statement: 'Because I do not want to make any mistakes, I use a tax professional to prepare my tax return.' The demand for tax practitioners does not seem primarily driven by the desire to avoid paying taxes, but by a dual motivation to report correctly but at the same time pay no more than is required (Frecknall-Hughes & Kirchler, 2015).

Tax evasion is often not seen as a serious crime, despite the majority of taxpayers' willingness to abide by the law. In German surveys conducted by Schmolders (1959), approximately half of the respondents compared a person deliberately evading taxes with a cunning business man, while only one quarter judged such a person as a thief or deceiver. Similar results were reported by Song and Yarbrough (1978) and Vogel (1974). In Kirchler's (1998) study on social representations of taxes, respondents were asked to describe and evaluate a typical taxpayer, an honest taxpayer, and a tax evader. The description and evaluation of tax evaders were quite positive. Whereas typical taxpayers were rated most negatively and honest taxpayers most positively, tax evaders were evaluated neutrally. Moreover, tax evaders were described as being the most intelligent and as being rather hard-working, whereas the typical taxpayer was perceived as being rather lazy and not very intelligent. Honest people were perceived as hard working, but as less intelligent than tax evaders. While these findings suggest that attitudes towards tax evasion are positive, there may have been changes in the recent past. The OECD (2013) initiative of enhanced relationships and cooperative compliance has led to changes of paradigms and to investment in trust. The recent success of tax authorities in the fight against tax evasion on a large scale, especially in Germany, as well as the public shaming of tax avoidance by globally operating companies and their sophisticated, tax-efficient profit shifting strategies, have led to a greater awareness in the population of the necessity of taxes. It can be assumed that large-scale tax evasion is seen as serious crime, whereas small-scale evasion might still be seen as minor crime. Indeed, a representative survey study on tax morale in Germany found that the population believes it is important to comply with the tax laws. Tax morale – which Torgler (2007) defines as an intrinsic motivation arising from the

moral obligation to pay taxes correctly – is high. At the same time, citizens expect more fairness: 95% believe that the state is too wasteful with their money and 85% think their personal tax burden is too high. In addition, many think that the tax code is too complicated and unfair (Bund der Steuerzahler Deutschland e.V., 2014).

### 16.3.2 Taxes as Burden and Restrictions

Taxes are often seen as a burden. Despite citizens' appreciation of public goods and policy regulations of consumer behaviour, organizations and markets, citizens dislike paying taxes and sometimes are even willing to take on additional costs in order to avoid taxes. They have a stronger preference for avoiding tax-related costs than for avoiding equal-sized or even larger monetary costs unrelated to taxes. For example, Sussman and Olivola (2011) showed that consumers considered goods advertised as 'tax-free', i.e., with a price reduction in the magnitude of the sales tax, to be more attractive than goods with a larger price reduction not linked to tax. Representations of taxes and reactions to tax burden differ between groups of taxpayers, e.g., employees and self-employed. The self-employed and entrepreneurs who take the gross income and collect value added tax often perceive taxes as too high, do not perceive a balanced return of benefits, claim taxes to be unfairly distributed and as limiting their freedom. In a study by Kirchler (1998), blue-collar workers, white-collar workers, civil servants, self-employed and entrepreneurs wrote down what came to their minds when thinking about taxes. Analyses of these free associations showed clear differences between the groups. Blue-collar workers, white-collar workers, and civil servants mentioned public goods, welfare, social security, and justice. Thus, they had an exchange between paying taxes and receiving benefits in mind. The self-employed and entrepreneurs mentioned audits and fines and taxes as a disincentive to work, as public constraint, the complexity of tax law, bureaucracy and the non-transparent public use of tax revenues. Thus, these groups thought of taxes in terms of high compliance costs, and as a limitation on their freedom to run their businesses.

Taxes can be seen as restrictions. People often resist attempts to limit their freedom of choice. According to reactance theory (Brehm, 1966), restricted freedom is often responded to by doing the opposite of what is requested. If the self-employed and entrepreneurs perceive taxes as a restriction on their freedom, they are likely to develop reactance motives which manifest in a decreased tax morale and a search for opportunities to avoid or evade taxes. Especially in their early business years, the self-employed and entrepreneurs may experience taxes as an unbearable loss when they focus on their gross income (including the value added tax collected and to be passed on to tax authorities) and feel as if they are paying taxes 'out of pocket'. The longer they run their business, the more they will shift their focus: they are likely to develop strategies to separate direct and indirect taxes from their income and keep (mental) accounts for income tax, social security payments, or valued added tax (Muehlbacher & Kirchler, 2013). When tax revenues are (mentally) kept aside, taxes are not seen as being paid out of pocket, and are seen more as a forgone gain rather than a painful loss. Kirchler (1999) investigated whether self-employed' and entrepreneurs' resistance to taxes was dependent on the length of time they had run their business: a shorter business history was correlated with increased perceived restrictions of freedom and consequently higher intentions to evade taxes.

## 16.4 PROFIT SHIFTING AND AGGRESSIVE TAX PLANNING BY COMPANIES

### 16.4.1 *Legal and Psychological Perspectives*

In the globalized economic world, companies have formed multinational corporations. Tax planning schemes allow them to legally reduce tax liability to a minimum by so-called *profit shifting*, i.e., moving the taxable profit to a country with lower tax rates. Tax planning schemes have become a major competitive factor contributing to steadily declining corporate tax rates in the European Union. Tax policy and discussions about efficient reactions to tax avoidance schemes are dominated by the OECD initiative against aggressive profit reductions and transfers of profits (OECD, 2013). While the initiative aims at regulating the transfer of profits by international corporations, its success depends on new regulations in different countries and on the attitudes of taxpayers towards tax avoidance and tax evasion.

The struggle of individuals and businesses to improve their financial situation is widely accepted in society and perceived as a prerequisite of wealth. From a legal perspective, tax evasion is illegal, whereas tax avoidance and tax flight are usually considered legal behaviours which – though not following the spirit of the law – do follow the letter of the law (Frecknall-Hughes, 2013). From a macro-economic perspective, and apart from legal considerations, tax avoidance, tax evasion, and tax flight have similar negative effects on the national budget. From a psychological perspective, taxpayers perceive tax avoidance, tax evasion, and tax flight differently along legal and moral dimensions (Kirchler, Maciejovsky, & Schneider, 2003). In Kirchler et al.'s study, fiscal officers, students of economics and business administration specializing in auditing and accounting, business lawyers and entrepreneurs were asked to produce free associations to the terms tax avoidance, tax flight and tax evasion. All three activities were perceived as possibilities to save taxes. However, evasion was judged as illegal and immoral behaviour, whereas avoidance was perceived as legal and not immoral; tax flight was considered legal but immoral behaviour. Since the time of that study, citizens' views may have changed through recent media reports and public discussion of aggressive tax planning and profit shifting by multinational firms.

### 16.4.2 *Policy Perspectives*

Some recent contributions highlight the necessity of responding to multinational corporations' activities by developing rules and instruments to effectively control their tax behaviour. The OECD released recommendations on how to combat aggressive tax planning in 2013. Fuest, Spengel, Finke, Heckemeyer, and Nusser (2013) discussed policy options for tackling profit shifting and tax avoidance by multinational firms, such as extension of source taxation, residence taxation, fundamental reforms of corporate income taxation, and stricter reporting and transparency requirements. Hey, Schreiber, Pönnighaus, and Bierbrauer (2013) underline the need for an international

consensus on how to jointly regulate the taxpaying behaviour of citizens and businesses in order to effectively combat aggressive tax avoidance and to increase tax justice.

The problem, however, is that the tax planning strategies of multinational firms are not illegal. By exploiting the possibilities offered by complex and ambivalent laws, their activities may be at the border of the law but hardly over the border. They follow the letter of the law. In order to enhance willingness to comply with the spirit of the law, it seems necessary to establish a sense of right-doing and wrong-doing in corporate business and in society. If aggressive tax planning and tax avoidance strategies are made public, and if the public understands that egoistic profit-maximizing strategies are directed against the community, citizens' reactions (e.g., consumer boycotts) may have more impact on tax planning than complex laws that are adjusted by lawyers who chase the 'robbers' who continue exploiting ambivalences and loopholes in the law.

Citizens' judgements of unfairness of tax avoidance and evasion probably result from an everyday understanding of moral and immoral conduct, and probably not from an informed judgement against the background of the complex tax law. In Section 16.5, we consider how governments can design regulation strategies to strengthen the sense of right-doing for the community, to condemn what is against the community's welfare, and to enhance cooperation by individuals and companies.

## 16.5 REGULATION STRATEGIES BY TAX AUTHORITIES

### 16.5.1 Regulation and Power

Governments regulate the behaviour of citizens and companies through laws and institutions, specifically through tax laws and tax authorities. 'Regulation is essentially about the use of power and the debates about the nature of regulation are similar to those about the nature of "power" in political science discourse, "social control" in sociological discourse and "sanctions" in criminological discourse' (Freiberg, 2010, p. 84).

Power is defined as the potential and perceived ability of one party to influence the behaviour of another party (e.g., Freiberg, 2010; French & Raven, 1959; see also Gangl, Hofmann, & Kirchler, 2015). French and Raven (1959) and Raven (1965) developed the concept of bases of social power which distinguishes between coercive power, reward power, legitimate power, expert power, referent power, and information power. These different bases of power can be integrated into a two-dimensional structure of harsh (i.e., coercive and reward power) and soft (i.e., legitimate, expert, referent and information power) forms of power (Raven, Schwarzwald, & Koslowsky, 1998), which we will discuss under the generalized terms *coercive power* versus *legitimate power*.

Coercive power is related to the tax authorities' potential to punish. In a taxpaying context, coercive power aims at strictly monitoring taxpayers' behaviour and punishing misbehaviour. Until recently, the tools most often used to regulate tax behaviour were founded in the concept of coercive power and manifested as command-and-control

approaches through audits and fines. The concept of coercive power is based on legal compulsion as those who do not obey the rules of the authority will face criminal sanctions.

Legitimate power is related to citizens' perceptions of tax authorities' rightfulness and expertise. In a taxpaying context, the concept of legitimate power is founded on other bases than compulsion and pressure, instead trying to convince taxpayers that voluntarily cooperating is the right course of action (Raven, 1965, 1992, 1993; and also Pierro, Raven, Amato, & Bélanger, 2013; Tyler, 2006).

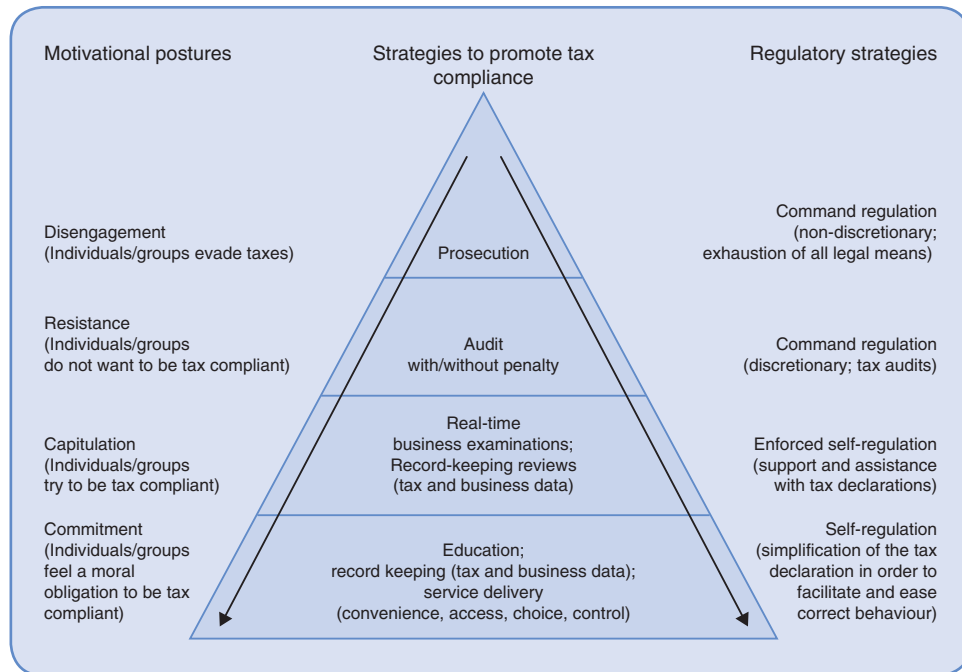
### 16.5.2 *Forms of Regulation*

With regard to forms of regulation, coercive power is related to prescriptive regulation. According to Freiberg (2010), prescriptive regulation relies on rules or statements that specify precisely what is required to be done. Such regulation enforces adherence to rules and statements, focuses on deterrence-based compliance, and is quite rigid. In contrast to this rigid, authoritarian paradigm, performance-based regulation and principle-based regulation are more flexible and are related to legitimate power. While performance-based regulation specifies desired outcomes, it is flexible with regard to the means applied to reach these outcomes. Principle-based regulation relies on agreements on conduct that are accepted in a group and expressed by objectives and duties at a high level of generality (Freiberg, 2010). While rigid forms of regulation, i.e., authorities approaching taxpayers in undifferentiated ways, are likely to be perceived as a manifestation of coercive power, more flexible forms of regulation are likely to be perceived in terms of power based on expertise and legitimization. Moreover, flexible forms of regulation stimulate the development of trust in authorities.

Flexibility means that tax authorities treat taxpayers in differentiated, partly individualized ways. V. Braithwaite (2003) has identified five motivational postures of taxpayers: Commitment and capitulation reflect an overall positive orientation towards tax authorities, whereas resistance, disengagement and game playing reflect a negative orientation. Commitment and capitulation are positively related to tax compliance, whereas the other three postures are related to tax avoidance and evasion. While commitment and capitulation are the most prevalent motivational postures, resistance, game playing, and disengagement are found less frequently.

Motivational postures describe the stance of taxpayers that tax authorities have to manage when seeking to change taxpaying behaviour. The Australian Taxation Office has developed a model which links motivating factors in taxpayers' compliance behaviour to the appropriate response by the tax office. Figure 16.1 shows the model, adapted from V. Braithwaite (2003) and James, Hasseldine, Hite and Toumi (2003): depending on the motivational posture of taxpayers, regulatory strategies should vary, encompassing self-regulation, enforced self-regulation, discretionary command regulation, and non-discretionary command regulation. When taxpayers admit wrongdoing, correct their mistakes and begin meeting the law's expectations, the tax officials' task is to educate, keep records, and deliver services and advice. Indeed, provision of services has been found to be significantly related to compliance (Gangl et al., 2013). When taxpayers behave in an adversarial fashion, show resistance and





**FIGURE 16.1** Australian Taxation Office compliance model

Adapted from Braithwaite, 2003, p. 3, and from James et al., 2003.

disengagement, tax officials should respond with much harder measures such as command regulation, and finally respond with prosecution.

It can be hypothesized that rigid, authoritarian regulation based on prescriptive rules and enforcement by coercive power manifestation leads to the impression that tax authorities are approaching compliant and less compliant taxpayers in a uniform way. The applied command-and-control tools are directed to all taxpayers independent of their motivation, their willingness and ability to comply, or their intent to free-ride. This undifferentiated approach may cause negative feelings such as uncertainty, anger, and anxiety. It may lead to perceptions of arbitrariness, and it may undermine trust.

On the other hand, more flexible regulation, especially responsive regulation, should lead to the perception of professionalism and expertise on the part of authorities. Distinctive measures – applied to react to commitment or resistance appropriately – are assumed to be perceived as necessary and just. Regulators need to have a variety of regulatory measures available, to apply them in response to taxpayers' behaviour, and to be realistic enough to use 'the iron fist' in case of repeated evasion. Ayres and Braithwaite (1992) in their model of responsive regulation assume that compliance is most likely when tax authorities follow an explicit enforcement pyramid: they propose a 'tit for tat' approach, by which increasing non-compliance is dealt with increasing seriousness of sanctions (Freiberg, 2010). Severe sanctions, serving as well-targeted threats, are assumed to increase honest taxpayers' feelings of security and protection against free-riders, and as protection of collective responsibility.

### 16.5.3 Regulation and Trust

Flexible regulation through both legitimate power and well-directed coercive power should strengthen the perception of the authorities as legitimized experts, and consequently increase trust in the authorities and cooperation with the authorities. It can also be argued that trust among citizens and trust between citizens and authorities are necessary preconditions for the accepted and effective use of coercive power and punishment by the authorities (Bailliet & van Lange, 2013; Parks, Joireman, & van Lange, 2013).

In the tax context, trust was differentiated into reason-based trust and implicit trust in the socio-cognitive trust theory (Castelfranchi & Falcone, 2010). Reason-based trust means that the tax authorities are trusted because they pursue relevant goals, because taxpayers depend on the authorities, and because the authorities appear competent and benevolent. In contrast, implicit trust is defined as an automatic and unconscious trust reaction to the perception that the tax authorities are part of one's own community, sharing one's own values.

## 16.6 INTERACTION CLIMATES BETWEEN TAXPAYERS AND TAX AUTHORITIES

### 16.6.1 Antagonistic and Synergistic Interaction Climates

In their synopsis of economic and psychological determinants of tax compliance, Kirchler, Hoelzl, and Wahl (2008) distinguish – on the one extreme – between an antagonistic interaction climate, i.e., taxpayers and authorities working against each other, and a synergistic interaction climate, i.e., taxpayers and authorities working together, on the other extreme. While the use of power, especially coercive power in a distrustful relationship between citizens and authorities, is assumed to foster an antagonistic climate, mutual trust and protective power are assumed to strengthen cooperation and foster a synergistic climate.

In an antagonistic interaction climate, mutual trust between taxpayers and authorities is eroded and compliance needs to be enforced. Tax authorities approach taxpayers as potential criminals who only comply with the law if forced to. Taxpayers feel prosecuted, repulse the tight net of rules limiting their freedom, and hide from the enforcing authorities by trying to take rational, utility-maximizing decisions whether to comply or to evade, on the basis of perceived audit probability and severity of fines in case of detected evasion. There is no binding psychological contract between the authorities and taxpayers prescribing cooperation, and no intrinsic motivation to follow the rules (V. Braithwaite, 2003; Feld & Frey, 2007; 2010; Rousseau, 1995). In an antagonistic climate, taxpayers neither trust in the benevolence of authorities nor in the cooperativeness of other taxpayers. If the authorities are not perceived as cooperative and other taxpayers are assumed not to pay their taxes properly, the intent to avoid and evade one's one tax duty is likely to be strong (Rothstein, 2000).

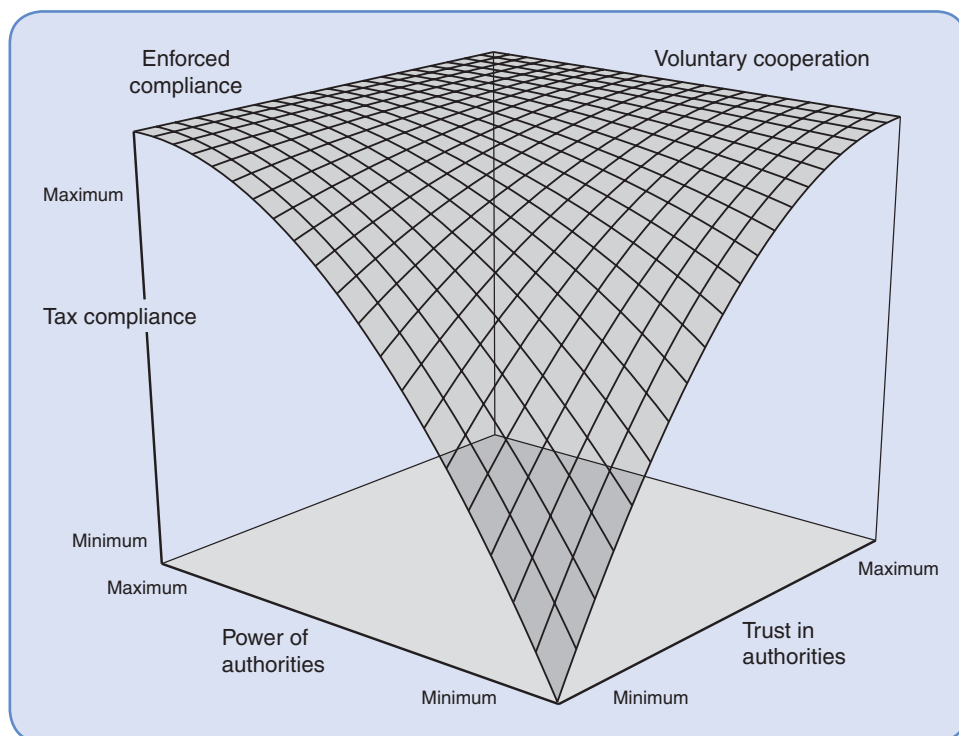
In a synergistic interaction climate, taxpayers and authorities trust in each other's willingness to cooperate voluntarily. A powerful legal system, a strong economy and especially an efficient government that provides essential services and guarantees

public goods can establish binding rules of fair play. Tax authorities are not seen as dominant agencies that enforce tax compliance, but as agents acting in the service of citizens towards the well-being of the community. Both legitimate power and reason-based trust in authorities are the prerequisites of a synergistic climate.

Authorities using fair procedures and engaging in assisting taxpayers rather than exclusively focusing on audits and fines are perceived as trustworthy. A strong psychological contract ensures voluntary cooperation. This resembles the trust paradigm identified by Alm and Torgler (2011) as one of the three paradigms of tax administration. In the traditional enforcement paradigm, taxpayers are treated as potential criminals. In the service paradigm, tax authorities acknowledge the necessity to make tax compliance easier by way of offering service. In the trust paradigm, the importance of building trust between interacting parties is emphasized, and trust is based on the expectation of both taxpayers and tax authorities that the other party will act beneficially (Gambetta, 1988).

### 16.6.2 Slippery Slope Framework

In the slippery slope framework, Kirchler, Hoelzl, and Wahl (2008) and Kirchler, Kogler, and Muehlbacher (2014) propose that in an antagonistic interaction climate, the strong power of the authorities leads to enforced compliance. In a synergistic climate, strong mutual trust leads to voluntary cooperation (Figure 16.2). Voluntary



**FIGURE 16.2** Slippery slope framework

Adapted from Kirchler, Hoelzl, & Wahl, 2008, p. 212.

cooperation depends primarily on trust in the state and its authorities; however, if cooperation does not occur voluntarily, tax compliance needs to be secured by force. Power includes all the measures that serve the purpose of deterrence, e.g., efficient tax audits and high fines for evasion. On the other hand, trust in the authorities requires tax laws which are understood by the taxpayers, services helping to comply, positive attitudes towards taxation and high tax morale by taxpayers, distributional and procedural fairness, and the belief that compliance is the norm rather than the exception, i.e., social norms demanding cooperation. Moreover, trust also originates from proper use of power, in the sense that the authorities protect the cooperative majority from free-riders.

The assumptions of the slippery slope framework were tested empirically by Wahl, Kastlunger, and Kirchler (2010). Specifically, it was examined whether tax compliance is high in cases of trustworthy authorities as well as in cases of deterrence. Moreover, the quality of compliance was examined. In a laboratory experiment, participants imagined living in a fictitious country and paying their taxes to authorities that were either trusted or not, and powerful or not. In 20 experimental periods, participants earned income and filed tax returns. It was found that participants were most compliant if authorities were described as trustworthy rather than untrustworthy and powerful rather than weak. Voluntary cooperation was high when authorities were described as trustworthy, and enforced compliance was high when the country was described as being ruled by powerful authorities. Similar results were reported by Kastlunger, Lozza, Kirchler, and Schabmann (2013), Kogler, Batrancea, Nichita, Pantya, Belianin and Kirchler (2013), and by Muehlbacher, Kirchler, and Schwarzenberger (2011). They confirm the assumptions of the slippery slope framework and show also that taxpayers feeling forced to contribute by the authorities attempt to think strategically about how to avoid tax pressure, rather than cooperating spontaneously.

The power-enhancing and trust-building measures proposed in the slippery slope framework have complex interactions and dynamics over time (Hofmann, Gangl, Kirchler, & Stark, 2014). Power exerted by authorities may evoke suspicion and mistrust by citizens, resulting in a vicious circle: mistrust by one party provokes mistrust by the other party, which justifies and deepens the mistrust by the first party (e.g., Castelfranchi & Falcone, 2010, Farrell & Knight, 2003; Nooteboom, 2002). However, power can also positively affect trust. The power of an institution can be perceived as a necessary precondition for trust (Bachmann, 2001). Mulder, Verboon, and De Cremer (2009) argue that the law and its enforcement define the norms to be followed, and sanctioning systems can be perceived as a means of enforcing societal norms. As a consequence, trust would increase due to authorities' power (Mulder, van Dijk, De Cremer, & Wilke, 2006). Korczynski (2000) argued that while trust is undermined if power is used to coerce cooperation, trust can increase when power is exerted by an authority that is seen as legitimate. According to Choudhury (2008), power and monitoring decrease trust when they are based on surveillance or unclear regulations, whereas the opposite is true when the exertion of power is rule-based and the authorities monitor behaviour in a fair manner. In summary, when the power of tax authorities is perceived as legitimate power, it likely has a positive effect on citizens' trust.

## 16.7 PRACTICAL IMPLICATIONS

Institutions and authorities are beginning to recognize that trust-building measures promote cooperation. New forms of interaction between authorities and taxpayers, termed cooperative relationships or horizontal monitoring, are being tested out in several countries. Beginning in 2005 in the Netherlands, tax authorities are switching from traditional vertical monitoring to horizontal monitoring (Stevens, Pheijffer, van den Broek, Keijzer, & van der Hel-van Dijk, 2012). Vertical monitoring is based on checking tax files retroactively, whereas horizontal monitoring focuses on fair play, understanding and transparency between taxpayers and the authorities, and the planning of future activities of businesses and their tax consequences. Horizontal monitoring is based on a trust relationship between taxpayers and the authorities which is recorded in a compliance agreement, and on an effective tax control framework.

If taxpayers are perceived to be selfish, profit-maximizing individuals, unavoidably it must be concluded that contributions will not be made voluntarily but only be paid when enforced. The strategies to secure tax compliance in this situation are audits and fines (Allingham & Sandmo, 1972; Srinivasan, 1973). However, evidence grows that these strategies are less successful than predicted by theory. Therefore, it is necessary to adopt strategies building on both economic and psychological arguments to promote cooperation (Alm & Torgler, 2011; J. Braithwaite, 2005; 2008; V. Braithwaite, 2009; James, Hasseldine, Hite, & Toumi, 2003). Reviews of empirical studies in economics and psychology provide ample evidence of the manifold determinants of tax compliance which have practical implications (Kirchler 2007). The following list contains some suggested measures (Alm & Torgler, 2011; Alm, Kirchler, & Muehlbacher, 2012):

1. Monitoring and audits are important to protect honest taxpayers from free-riders. Audits need to be focused on at-risk groups and effectively implemented. Audits need to be perceived as a manifestation of power with the aim of protecting cooperative citizens from free-riders. Negative sanctions need to be adequate in level and form, in line with retributive justice.
2. Tax authorities need to be well trained, and they need to cooperate intensively with legislators, judges, and international authorities in order to fight tax evasion and excessive tax avoidance. There is also need to strengthen the dialogue between commissioners, businesses and researchers. Tax authorities, and above all tax auditors, need to be efficiently trained so that they are both experts in tax law and experts in applying different regulation strategies effectively.
3. Tax law needs to be simplified so that taxpayers understand it and can abide by the law. Instead of a plethora of rules with exceptions, principles of behaviour need to be fixed in law to minimize the space for interpretation and negotiation. Services for taxpayers need to be improved. Taxpayers need to be segmented according to their needs, so that appropriate services can be offered to facilitate tax honesty.

4. Distributive justice and procedural justice need to be taken seriously. The use of tax money needs to be transparent; advertising campaigns should be used to inform the public of the services available, so that the fair exchange of tax contributions, on the one hand, for state services on the other is clear. Procedures for determining tax contributions need to be transparent and fair, and tax authorities need to ensure adherence to these procedures.
5. Establishment and communication of social norms of correct behaviour are necessary. Measures need to be taken that strengthen the identification of citizens and companies with the community.

## 16.8 SUMMARY

To summarize, this chapter highlighted that tax behaviour can only partly be understood by a simple reaction to audits and fines. It showed that it is necessary to understand how citizens see taxes in general, and tax laws and tax authorities in particular. It also showed that at the company level, it is necessary to move towards a system that can reduce tax avoidance, not only tax evasion. For tax authorities, one potential way is to rethink regulation strategies. Several recent approaches highlight the interaction between the power of tax authorities and the trust of citizens and companies in the tax authorities. These approaches incorporate important psychological concepts into tax policy and regulation.

## REVIEW QUESTIONS

1. What is responsive regulation?
2. Give four examples of economic and psychological determinants of tax compliance.
3. Describe the concepts antagonistic and synergistic interaction climate.
4. Is tax evasion perceived as a serious crime? Describe the empirical findings on this matter.
5. What are the differences between tax evasion and tax avoidance from a legal perspective and from a psychological perspective?

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