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Tax Compliance by Trust and Power of Authorities

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ABSTRACT The following is a summary of Kirchler *et al.*'s (2008a) framework for tax compliance. The 'slippery slope' framework distinguishes two forms of compliance. Whereas voluntary compliance is driven by trust in tax authorities, enforced compliance depends on the power of authorities. It is assumed, however, that the interplay of trust and power is crucial for both forms of compliance. The framework serves as a guideline for tax research and tax policy.

KEY WORDS: Tax compliance, trust, power

The 'Slippery Slope' of Trust and Power

Since the publication of Allingham and Sandmo's (1972) economic model of income tax evasion, a huge number of studies have tried to find empirical support for the deterrent effect of audits and fines. The evidence, however, is weak and instable (for a review see Kirchler *et al.*, 2008b). A similar puzzle is reported from psychological research, for instance for the impact of distributive justice on compliance (Wenzel, 2002). Based on an extensive review of the literature in economics, economic psychology and related disciplines (Kirchler, 2007), the 'slippery slope' framework was developed to integrate the puzzling findings. Therein, two forms of compliance are distinguished: voluntary and enforced compliance. It is assumed that each type depends on different factors. Whereas enforced

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compliance depends on (perceived) power of authorities to prosecute tax evaders, voluntary compliance is based on a trustful relationship towards authorities. Hence, the efficacy of the parameters from the economic model – the classical tools of deterrence – and more psychological variables, such as justice concerns, depend on which compliance form is prevalent.

The basic ideas of the 'slippery slope' framework are depicted in Figure 1. If compliance is voluntary (right side of Figure 1), high trust in authorities would increase cooperation. However, the trust-building effort of authorities is assumed to have a diminishing marginal return on voluntary compliance. Regarding enforced compliance (left side of Figure 1) an increase of power is necessary to enhance cooperation, again with a diminishing marginal return. The 'slippery slope' arises by the interaction of power and trust. The framework assumes that power also has some influence on trust and vice versa. For instance too frequent tax audits and rigorous penalties might corrode the trust of compliance-minded taxpayers, no audits at all might bring up doubts and distrust about the efficiency of tax authorities' work. A trusting taxpayer, on the other hand, might help to increase authorities' power, e.g. by whistle-blowing tax evaders.

The idea to differentiate taxpayers by their motives to comply or not comply is not entirely new. In an early theoretical paper, Otto Veit (1927) distinguishes tax morale from the willingness to pay taxes. Whereas the first term stands for the taxpayers' behavior – the amount of taxes paid – the latter term captures the psychological disposition to do so. Although his labeling might be misleading, Veit's definitions undeniably have some familiarities with the two forms of compliance in the 'slippery slope' framework. A related distinction can be found in the work of Feld and Frey (2002), who differentiate between intrinsic and extrinsic motivation

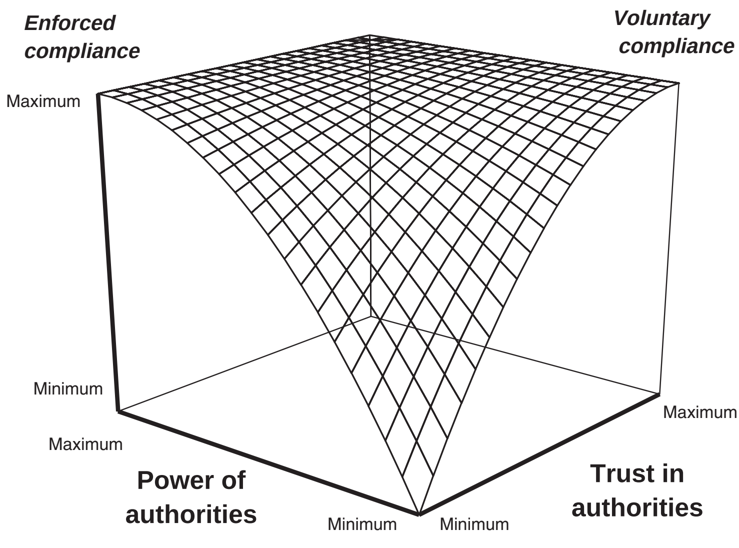

Figure 1. Graphical depiction of the 'slippery slope' framework (reprinted with permission from Kirchler *et al*. 2008a).

to comply with the tax law. Braithwaite (2003) specifies five motivational postures and argues for responsive regulation, i.e. to support honest taxpayers, even if they make mistakes from time to time, but to prosecute persistent tax evaders with the full rigor of the law. The 'slippery slope' framework captures these ideas and proposes power and trust as the major determinants for each form of compliance. Accordingly tax authorities can take measures to increase their power, e.g. by emphasizing the potential fines in their marketing. Or they can take measures to increase their trustworthiness, e.g. by making fair and transparent decisions and by being respectful towards their clients. With the right mix of measures, a shift from a cops-and-robbers climate towards a service–client relationship should be achieved.

Recently attempts have been made to formalize the assumptions from the 'slippery slope' framework to render more precisely the effects of trust, power and the social norm that arises if compliance- or evasion-oriented taxpayers hold the majority (Prinz *et al.*, 2010). Figure 2 shows regression results from an empirical test of the 'slippery slope' framework. Four scales measured trust, perceived power, the extent of voluntary and enforced compliance among a representative sample of self-employed taxpayers. For this analysis, voluntary and enforced compliance were averaged per person to indicate overall compliance intentions (regardless of whether compliance was enforced or voluntary). The figure shows the impact of trust and power on this overall compliance variable.

To summarize, the 'slippery slope' framework emphasizes the importance of trust and a fair interaction between tax authorities and their clients. Besides the

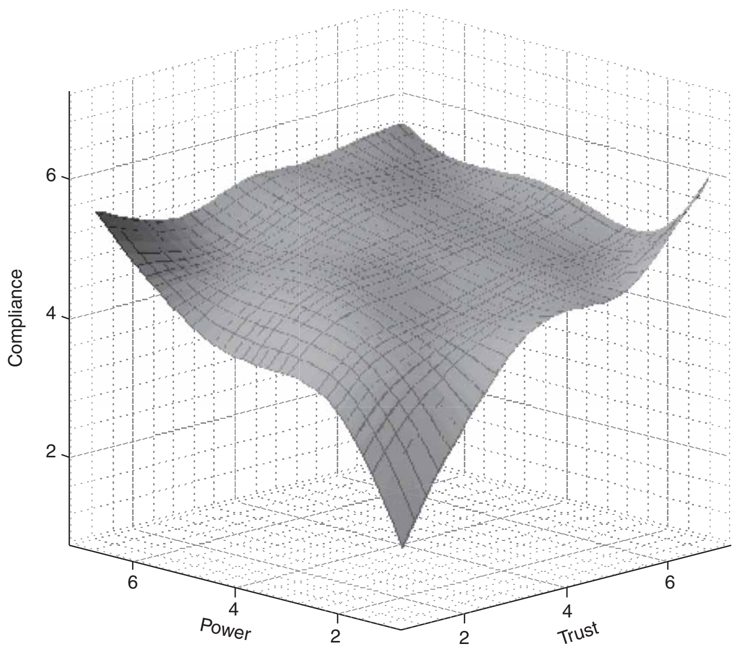

Figure 2. Empirical evidence for the 'slippery slope' framework.

well-studied instruments of deterrence, these are necessary to foster and stabilize the voluntary cooperation of honest taxpayers.

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