UNIVERSITY OF LIMERICK
OLLSCOIL LUIMNIGH

KBS RESEARCH BULLETIN

FEBRUARY 2020

ISSUE 80

As a leading Irish business school in a public university system, KBS is committed to excellence in teaching and to fostering knowledge and understanding of business and society within a diverse, research active and socially engaged environment.

Research at KBS serves this mission. Our goal is to cultivate excellence in research, underpinned by our core values including commitments to promote learning and discovery as well as social responsibility and ethical behaviour; to protect academic freedom and enhance knowledge; to maintain a future orientation and an international perspective; to promote inclusive and sustainable societies and facilitate the involvement of industry.

Our research finds a focus in the four academic departments of the School as well as in active research clusters and broad thematic descriptors. The current research clusters are: Accountability (ARC); Efficiency & Productivity Analysis; Emerging Risk Assessment & Underwriting; Human Rights & Development Practice; Interpretive Consumer Research; Psychological Science in Business; Privatisation & PPP; and Quality of Work. Research seminars are also regularly organised by the themes of Work, Knowledge & Employment and Public Policy, Enterprise, Governance & Sustainability.

See http://www.ul.ie/business/research for more information.

Trust and Power as Determinants of Tax Compliance across 44 Nations

Batrancea, L., Nichita, A., Olsen, J…., Doyle, E. et al.

Synopsis

The slippery slope framework emphasizes the importance of trust in authorities as a substantial determinant of tax compliance together with traditional enforcement tools like audits and fines. Using data from a 44-nation study spanning five continents, we find that trust in authorities and power of authorities, increases tax compliance intentions and mitigates intended tax evasion across societies that differ in economic, sociodemographic, political, and cultural backgrounds. We also show that trust and power foster compliance through different channels: trusted authorities (perceived as benevolent and enhancing the common good) register the highest voluntary compliance, while powerful authorities (perceived as effectively controlling evasion) register the highest enforced compliance. These findings have implications for authorities across the globe striving to choose the best practices for tax collection in order to create and maintain thriving societies.

Introduction and Background

Traditionally, policy makers have based their tax collection strategies on enforcement and deterrence. However, institutional deterrence entails higher costs of administration, is susceptible to corruption, and may even reduce tax compliance when citizens perceive a violation of their fairness concerns. As a result, alternative determinants of tax behaviour, for instance, fairness considerations, social norms, attitudes, and trust in authorities have gained increased attention in recent years.

The slippery slope framework integrates different perspectives on tax compliance behaviour. The key assumption is that compliance is influenced by two major determinants, i.e., trust in authorities and power of authorities. Accordingly, a high level of tax compliance can be achieved either by (1) high trust in the authorities or (2) high perceived power of the authorities. The framework differentiates between voluntary and enforced tax compliance as different qualities of cooperation with the authorities. Increasing trust in authorities results in voluntary compliance, whereas enhancing the power of authorities yields enforced compliance. Importantly, citizens' voluntary tax compliance – on the basis that it is dutiful, right, and moral to pay taxes – may provide tax systems with wide-ranging long-term benefits: taxpayers register with authorities for tax purposes, due dates for tax return filing and taxpaying are met, and tax liabilities are accurately disclosed. As a result, administrative costs incurred by monitoring compliance and auditing honest taxpayers are decreased. In contrast, enhancing the power of authorities may serve as an alternative means to raise revenues through enforcement. However, in a climate with prevailing high power, most taxpayers defer to the law out of fear of detection or due to a perceived risk of high fines despite motives for noncompliance. Leveraging enforced compliance requires the presence of a powerful authority that ensures equitable tax regulation, conformity with the law, and effective levying by curtailing noncompliance and tax cheating.

Issues and Questions Considered

The Slippery Slope framework treats trust and power as two independent factors, but the authors acknowledge that they might influence and reinforce each other in different ways. For instance, increasing the power of authorities through hiring qualified tax inspectors, setting higher audit rates, and imposing steeper penalties, may be interpreted as an efficient and justifiable way to mitigate tax evasion by compliant taxpayers, leading them to trust and comply to a greater degree. However,

AUTHORS

Larissa Batrancea
Faculty of Business,
Babes-Bolyai University,
Romania

Elaine Doyle
Kemmy Business School
University of Limerick

KEMMY BUSINESS SCHOOL
University of Limerick

relying too much on power, especially if not used properly to identify free riders, may be perceived as unjustifiable or as a sign of distrust, resulting in resistance to the tax system and noncompliance. On the other hand, when citizens exhibit higher trust, their support of tax officers (e.g., through whistleblowing) enables authorities to intensify auditing and heighten sanctions, so that trust acts as a moderator when it comes to the effectiveness of authorities' power. The results from previous empirical studies on potential interaction effects of trust and power do not provide conclusive evidence of this interaction effect.

The present study provides empirical evidence from a large-scale scenario-based experiment by testing the slippery slope framework in 44 nations. The countries cover the broadest range of economic, sociodemographic, political, and cultural characteristics. We illustrate the impact of trust and power and their dynamics on four central dimensions of taxpaying: intended tax compliance in general, voluntary tax compliance, enforced tax compliance, and intended tax evasion. We propose that (1) high trust in the tax authorities induces a higher level of intended compliance, stronger voluntary compliance intentions, and a lower level of tax evasion than low trust in the tax authorities; and (2) that high power of authorities induces a higher level of intended compliance, stronger enforced compliance intentions, and a lower level of tax evasion than low power of authorities. The large-scale setting allows us to also investigate the potential interaction of trust and power. Based on related previous research, we expect that (3) trust moderates the role of power, namely that the effect of high power versus low power is stronger under the condition of high trust compared to a situation of low trust.

Methodology

Participants (n=14,509) across 44 countries were randomly assigned to one of four scenarios, developed to manipulate trust and power in a hypothetical country: Varosia, resulting in the following combinations: low trust and low power; low trust and high power; high trust and low power; high trust and high power.

Every scenario comprised a combination of trust-related and power-related information. Firstly, authorities in Varosia were described either as highly trusted by citizens, transparent, providing free counselling on taxation matters, service-oriented, and concerned about citizens' opinion (high trust condition) or the opposite (low trust condition). In the second part, authorities were described as being either highly effective in prosecuting tax crimes, having a large budget to fight tax evasion, and imposing substantial monetary penalties for detected evasion (high power condition) or the opposite (low power condition). After being asked to imagine living and paying taxes in this country as a self-employed business owner, participants completed a 27-item questionnaire comprising manipulation checks for perceived trust and perceived power, scales on four different types of tax compliance intentions and motivations, items measuring perceived similarity between experimental scenarios and participants' home countries, and socio-demographics.

Outcomes and Findings

Both trust in authorities and power of authorities were found to be important determinants of tax compliance intentions around the world, irrespective of demographic coordinates, economic systems, social climates, political regimes, or cultural backgrounds.

Increasing trust led to higher intended tax compliance in all countries. Higher power had a positive effect on intended compliance in all but one country. However, there was a (small) negative interaction effect most pronounced in countries with a high level of trust in authorities and well organized tax administrations. This can be interpreted as a sign that strict enforcement in the form of high audit rates and severe fines may result in resistance provoking noncompliance, and might be problematic within a system where high compliance is already established. Nevertheless, intended tax compliance was maximised when both trust and power were high, impling that revenue bodies should combine the deterrence approach with services that increase trust in the authorities in order to increase tax compliance.

Voluntary tax compliance was dependent on trust in authorities. While the overall effect of power was negative, the underlying country-pattern was mixed. If, however, high power was paired with high trust, the effect of both trust and power on voluntary compliance was positive. Thus, authorities should consider increasing power together with trust if they aim to raise levels of voluntary compliance among taxpayers.

High power increased enforced tax compliance in all countries, although to different extents. Trust generally had no significant influence on enforced tax compliance. The overall results imply that, in the case of both high trust and high power, the feeling of being forced to pay taxes decreased in comparison with high power alone. In general, authorities can presume that increased deterrence measures will impact upon taxpayers' enforced compliance within the tax system.

High trust and power both reduced tax evasion. The significant negative interaction indicates that the level of tax evasion was reduced even further when high trust and high power were combined.

Taken together, our findings call for a shift in the conversation about taxation, replacing one-sided deterrence approaches with multifaceted strategies encompassing economically based as well as socio-psychologically driven determinants. The central implication of our study is that at the base of a nation's endeavours to enhance tax compliance there are two pervasive dimensions: citizens' trust in authorities and their perceptions of authorities' power. Considering both dimensions is vital, because facilitating enhanced tax compliance within the economy reverberates across many other societal areas like education, health care, and social welfare.

The underlying paper was published in the Journal of Economic Psychology, Volume 74 and a full copy can be obtained at

https://doi.org/10.1016/j.joep.2019.102191

Authors:

Batrancea, L., Nichita, A., Olsen, J…., Doyle, E. et al.

For further information and comments, please contact:

Dr Deirdre O'Loughlin

Assistant Dean, Research

Kemmy Business School

University of Limerick, Ireland

T: +353 61 213375

E: Deirdre.OLoughlin@ul.ie

Forthcoming Research Bulletin

Title: Lifting the lid: the private financing of motorway PPPs in Ireland

Authors: Palcic, D., Reeves, E. and Stafford, A.

About the KBS Research Bulletin

The purpose of the KBS Research Bulletin series is to make our research more readily accessible to a wide range of interested stakeholders, and so to allow our work to have a useful impact on the society in which we operate. We regard this as an important part of our stakeholder engagement. The dissemination of these bulletins aligns with both the UL focus on excellence and impact in research, and on the KBS strategic goals of cultivating excellence in research while contributing to our community of stakeholders in a responsible and sustainable manner.

KEMMY BUSINESS SCHOOL
University of Limerick