

# Psychological Factors affect Tax Compliance- A Review paper

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## ABSTRACT

*Tax noncompliance is a serious challenge facing tax administration and hindering tax revenue performance. A number of factors may be responsible for low compliance in income tax administration in any revenue institutions in any countries. The development of tax decision-making approach/s has focused on economic and behavioral/ attitudinal factors affecting compliance. A possible explanatory factor that has been identified in these decision making mode/s is tax Morale. This study examines the influence of psychological factors on tax compliance decisions. To recognize 'variables of tax compliances' analysed by various Researchers, which includes factors of psychological to be of value for decisions to make on tax compliance is emphasised in this volume. And also introduces the main contributions that have attempted to explain the agreement and obvious disagreement between the evidence on the reaction of taxpayers' attitude towards tax compliance through psychological factors. However, taxpayers' attitude has been identified as crucial one factor that play important role in influencing tax compliance behavior. Many Economic researches/studies have revealed that Tax compliance is based on individual decisions on paying and evading Tax compliance. The researches have further substantiated that the 'impact' of large number of potential determinants of voluntary compliance on their individual income/profit, i.e. social norms, equity and fairness, perception of political/ government, and accountability towards tax compliance attitude.*

**Key Words:** Tax compliance attitude towards taxes, tax morale, social norms, equity and fairness, perception of political/ government.

## 1. Introduction

For proper functions of a Government 'Financial Resources' should be dominant to its expectations of the public. Further, imposing of taxes is done on various streams to finance on development projects. Further, in most countries the domestic Tax base is destabilized due to Tax non-compliance, by tax evasion or avoidance (IMF2011). Auld & Miller (1984) have made statement that "Tax is an instrument that stabilizes the economy and reduces private demand where resources can also be released for public sector use". In 1978 Song & Yarbrough have defined the meaning of Tax Compliance as "Tax payers' ability is to comply with Tax Laws." The aim of the study is to be identified different theories stated by different authors of psychological factors and its value of importance for further policy perspective. Many Tax Authorities have revealed that 'Tax Compliance' is a major problem and it also reveals that to persuade the Tax payers to

comply with the Tax requirement is of great difficulty even though the 'Tax Laws are not always precise' (James and Alley 2004: 29) and are determined by ethic, legal environment and other situational factors. However, according to Kirchler (2007) Tax compliance is Tax Payer's willingness to pay their Taxes. Schmolders(1960:38) argues that "Consciousness about the state leads to 'citizens' civic and tax 'sentiments' and to a fundamental attitude with regard to problems of 'their' state" that such statement can explain further that compliance behaviour should begin from the question "how is the state mirrored in citizens' minds?"

The meaning of "Tax compliance" has been defined in different aspects. (Example) Andreoni, Erad & Feinstein (1998) stated 'Tax Compliance' should be defined as the willingness to obey 'Tax Laws' in order to accomplish the economic stability of its country. Alm (1991) and Jacson & Milliron (1986) have defined 'Tax Compliance' as reporting & declaring of Income and payment of Taxes by fulfilling the requirement of laws/regulations and Court judgements.

The attitude is most impotent factor which determines on individual taxpayers' to comply or not to comply. Attitudes towards tax defining as influence for compliance because it represents taxpayer's inclination to respond positively or negatively to a particular situation (Eagly and Chaiken, 1993; Ajzen, 1993). There are different ways to operationalize and measure attitudes towards taxation starting from general judgments of the government and state (Schmolders, 1960), subjective assessments of tax evasion (Porcano, 1988), attitude ending with moral attitudes towards tax evasion (Orviska and Hudson, 2002).

Several empirical studies revealed a statistically significant link between attitudes and self-reported behaviour (Chan et al., 2000; Trivedi et al., 2004). Nevertheless, because the link is weak in most of the studies, i.e., attitudes cannot be fully perceived as a convincing proxy for behaviour, results have to be cautiously interpreted (Kirchler, 2007: 55).

Further, individual attitudes towards Tax evasion are often found to be quite positive (Kirchler et al: 2008). A model of tax evasion behaviour developed by Weigel, Hessing and Elffers (1987) consider social and psychological conditions, including attitudes and moral beliefs about tax evasion. Many studies on tax evasion found significant, in addition weak relationships between attitudes and self-reported tax evasion (Trivedi, Shehata, and Mestelman, 2004).

## **2. Psychological factors**

Many researches have been done for analysing of behaviour of tax compliance and it has been revealed that psychological factors are most important factors to determine the tax compliance behaviour. The perception of political government accountability can be categorised as social norms, public spending, perceived fairness on tax system and moral tax.

In general Tax attitude depend on the perceived use of funds collected and therefore it is the knowledge as well (Kirchler et.al. 2008), *moral, personal, social & national norms*. In addition attitudes, norms are important determinants of compliance. Further, behavioural intentions are also determined by subjective norms (Ajzen 1991). (Kirchler et al. 2008) Norms are behavioural standards on three different levels. i.e. individual level, social level & national level. On *individual level* norms are defined standards on how to behave. Individual mindset on dealing with issues like tax policy, public goods, tax regulations etc. constitutes the social psychological determinants of tax compliance behaviour.

### **2.1 Social norms**

Researches on 'Tax' behaviour have been dealt with ethical standards i.e. personal, social and societal norms where the public develop sufficient moral standards in a society. Particularly on the aforesaid social norms that regulate 'Tax' behaviour in society. (Wenzel, 2003 – 2004).

The theory of Personal Norms - Experiments/researches reveal that 'personality' evades Tax compliance. It includes moral reasoning, values, religious beliefs etc., (Adams & Webley, 2001; Kirchler & Berger, 1998; Webley, Cole & Eidjar 2001) whilst altruistic orientation including community values advances 'Tax Compliance' (Blamey & Braithwaite, 1997; Braithwaite, 2003a). Honesty is a strong 'Personal' value (Porcano 1988) and religious beliefs (Grasmick, Bursik, & Cochran, 1991; Stack & Kposowa, 2006; Torgler, 2003b, 2006)

Literature on norms, are the behavioural standards upon personal, social reference groups, and collective level (Kirchler, 2007: 70). Standards of behaviour such as altruism, norm-dependency, or religious beliefs usually correlate with high Tax ethics and willingness to comply, under Personal norms. Social norms represent patterns of behaviour similarly judged by others (Alm et al., 1999). The level of non-compliance will decrease if the reference group signal the non-compliance behaviour is acceptable of a Tax payer. Relationship between Tax payer and authorities as well as the Tax legislation represent the integrated cultural standards of societal norms. On mutual understanding between the Tax payers and the authorities compliance could be achieved.

Many studies have also proved that Tax compliance is related to political affiliation. General public who are in favour of Political parties with social democratic values tend to comply more than the public voting for liberal parties (Wahlund, 1992). It is found that the tax payers who do not anticipate shame and guilt in case of norm violation are more compliant than the Tax payers with strong values for corporation. (Grasmick et al., 1991).

It has been found by Sigala, Burgoyne, and Webley (1999) that social norms are one of the most important predictors of Tax compliance. Further, by approval or disapproval the norm following /norm breaking is accepted in a society and also individual behaviour is synchronized by the norms developed (Alm, McClelland & Schulze 1999). As said earlier, to emphasis on tax behavior, by Wenzel (2005a) a field experiment was conducted to prove that social norms regulating compliance are based on perceived frequency of avoidance or evasion and societal acceptance of evasion. (Fehr, Fischbacher, & Gächter, 2002; Fehr & Gächter, 1998) the social norms are surrounded in socially shared beliefs and thoughts about how members of a group should behave. Further experiments have proved that communication about correct tax behaviour, and disapproval of noncompliance lead to tax honesty (Alm et al. 1999; Trivedi, Shehata, & Lynn, 2003; Wenzel, 2005b).

Public attachment to their reference group or the society mediates relationship for strong social norms to comply (Wenzel, 2004). This empirical finding proved, as in line with self-categorization theory (Turner, Hogg, Oakes, Reicher, & Wetherell, 1987), this theory assumes that individuals are more likely to be influenced by the norms recognized by their group if they understand the group to which highly relevant to the self image and if they recognize with their group.

Another study said that the public with a high sense of civic duty comply with tax law because of their genuine motivation, and not because they are forced by sanctions and audits (Frey & Eichenberger, 2002). Results on tax behavior in different countries highlight the importance of societal norms, as point out by the studies confirming national differences conducted by Alm, Martinez-Vazquez, and Schneider (2004), Alm, Sanchez, and deJuan (1995), Alm and Torgler (2006), Chan, Troutman, and O'Bryan (2000), Gërkhani (2004), Gërkhani and Schram (2006), Schneider (2004), Torgler (2003a), and Torgler and Schneider (2007). Weigel and Hessing (1987) earlier found that ethics, attitudes and moral beliefs impacted upon tax compliance behavior according to their psychological model of tax compliance.

Further studies found that communication about correct tax behaviour, and disapproval of noncompliance lead to tax honesty (Alm et al., 1999; Trivedi, Shehata, & Lynn, 2003; Wenzel, 2005b). Sigala, Burgoyne, and Webley (1999) found that social norms are one of the most important predictors of tax compliance. With

regard to tax behavior, a field experiment conducted by Wenzel (2005a) showed that social norms regulating compliance are based on perceived frequency of avoidance or evasion and societal acceptance of evasion.

## 2.2 Fairness and Equity

Fairness and equity are another factor that people highly communicate. Although tax fairness is only one factor in achieving overall compliance, the New Zealand Government for example, has continuously placed great emphasis on this criterion. Other social and psychology studies have found that the fairness and equity of a tax system also impacts upon compliance levels (Tan 1998).

Perceived fairness determines tax compliance (Andreoni et al., 1998; Kirchler, 2007). On the other hand, talk about unfairness serves rationalization and justification of tax non-compliance (Falkinger, 1988). Perceived fairness of taxation has been found to be co varying strongly with compliance.

Spicer (1974) found a considerable association between fairness and tax evasion while Song and Yarbrough's (1978) study discovered a significant association with 75% of the subjects stating that the ability to pay was more significant than the benefits. A further study which found a link between taxpayers' perceptions of fairness and tax compliance behaviour in Hong Kong was conducted by Richardson (2006).

United States of America (USA) and Hong Kong had a positive relationship with tax compliance, as Chan, Troutman and O'Bryan (2000) found that taxpayer attitudes (fairness). A good tax system, in order to achieve various objectives, declared in Bhatia (1976), a good tax system, aims chooses and adhere to certain principles which become its characteristics.

The most explicable requirement of equity or fairness is to treat equal people in equal circumstances in an equal way (James 2000) it says. A good tax system must be designed on the basis of an appropriate set of principles, such as equality or fairness and certainty. However, some other studies have found no association between tax fairness perceptions and tax compliance behaviour (Vogel 1974; Porcano 1988 and Antonides and Robben, 1995). Multi-dimensional nature of tax fairness as a tax compliance variable is a commendable reason for the inconsistency as suggested by Jackson and Milliron (1986) and Richardson and Sawyer (2001). If tax authorities are perceived as supportive, tax compliance increases (Kirchler, Niemirowski & Wearing, 2006). Fair treatment of taxpayers and a culture of mutual understanding between tax authorities and taxpayers improve trust in authorities (Job & Reinhart, 2003; Tyler, 2001; Wenzel, 2006). In line with this, if tax law favored particular income groups relative to others, procedural fairness was perceived as low (Murphy, 2003). Fairness perceptions are enhanced by the provision of information on tax law (Wartick, 1994), as well as by participation in the development of tax law and in decisions on the use of tax revenues (Torgler, 2005). Procedural justice concerns the process of resource distribution. It was found that procedural justice is high when individuals perceive the rules applied for the distribution of benefits and costs as fair, and treatment by tax authorities as friendly, respectful and supportive (Leventhal, 1980).

Tax amnesties allow tax evaders to retroactively file their taxes without being punished, leading to higher tax revenue. However, tax amnesties can have negative effects on the compliance of honest taxpayers who feel materially disadvantaged (Hasseldine, 1998; Sausgruber & Winner, 2004).

If an individual's tax burden is heavier than that of comparable other individuals, tax compliance is likely to decrease. On the individual level, taxpayers are concerned about the fairness of their outcomes, and they want to be treated relative to their merits, efforts and needs.

### 2.3 Tax Morale

“The attitude of a group or the entire population of taxpayers is the question of accomplishment or ignorance of their tax duties” is the definition for Tax Moral. It is anchored to citizens’ Tax attitude and in their perception to be citizens, is their inner acceptance of their Tax duty/liability and acknowledgement of sovereignty of the state” (Schmoelders, 1960, p. 97).

A significant impact on payment of taxes as well as on avoidance thereof is one of the influencing factors of tax compliance. Tax morale is defined as the collective attitudes of a group or population to comply with tax law (Schmölders, 1960). Some authors further stated individuals are not solely motivated by maximization of their own wellbeing but also by their feeling of responsibility towards the society (Orviska & Hudson, 2002) as it is found that the Tax morale is linked to the motivational concept of civic duty.

Literature is meant under tax morale is the motivation of a person to pay taxes real characteristic of the person, which is like an individual willingness or a moral obligation or a belief and views in a social contribution as a result of paying the taxes. Tax morale is also interpreted as an understanding of the principles/values of a person has on the liability to pay taxes recommendation was also made by Kornhauser (2007) to the IRS (Inland Revenue Service) that they endorse a tax morale approach to compliance that recognized the varying attitudes and behaviours of taxpayers. Therefore, the attitude of a person towards paying taxes, is his/her individual perceptive and norms and in it self-motivation can be expressed by the term “tax morale”.

Studies show that trust is negatively related to tax evasion, i.e., low trust in tax authorities are correlated with high levels of tax evasion (Richardson, 2008). Under the form of audits and fines on tax evasion are found in many studies and a significant power is effective on persuasion.(e.g., Allingham & Sandmo, 1972; Andreoni et al., 1998; Fischer et al., 1992).Therefore, term on tax evasion refers to intentional act of breaking the law in order to reduce taxes (Elffers, Weigel, & Helsing, 1987; Sandmo, 2003; Webley, 2004).It involves acts of omission (e.g., failing to report certain revenues) or commission (e.g., false reporting of personal expenses as business expenses) and is liable to prosecution penalty and fines (Kirchler, 2007).

Some Studies have revealed that ‘tax morale’ has higher legitimacy for political institutions that has led to higher tax morale values consequently has become an important variable to investigate. (Torgler and Schneider 2007).Therefore, compliance is highest in the countries characterized by high control of corruption and low size of bureaucracy (Picur and Riahi-Belkaoui 2006). This was further evidenced in a study of 30 developed and developing countries (although primarily non-African) that tax morale.Tax morale and compliance is higher in countries characterized by high control of corruption and low size of bureaucracy (Picur and Riahi-Belkaoui 2006). This was further evidenced in a study of 30 developed and developing countries (although primarily non-African)

(Feld and Frey (2007) show the importance of the relationship between taxpayers and tax authorities, emphasizing that mutual respect increases the tax compliance level. Investigations support the idea that trust of the authorities positively influences the tax compliance (e.g., Scholz & Lubell, 1998; Torgler, 2003).

Various studies report that trust in the government and in governmental institutions positively influences tax morale (Fjeldstad, 2004; Pommerehne & Frey, 1992; Torgler, 2005; Torgler & Schneider, 2004). Power of authorities is also said to have an impact on tax morale. According to Frey (1992), power expressed through tight monitoring and severe punishment of non-compliant taxpayers crowds out tax morale, thus leading to even higher levels of non-compliance. Frey (2003) argues that taxpayers are endowed with a considerable amount of civic virtue and tax morale, which shapes their tax compliance behaviour when integrated in the general context of the relationship between taxpayers and tax authorities.

Some Entrepreneurs justified their negative attitude for paying taxes above all because of the high tax rate (Schmölders 1959; Kirchler 2007). Upon the first valuation of tax morale as the expression of tax compliance, subjective tax burden was used as an indicator in the research conducted at the University of Cologne and it was found out that the level of willingness to pay taxes of entrepreneurs is lower than that of employees. (Strümpel 1969; Torgler 2007) In the next similar research, the tax system was used as an indicator, where the differences of the tax systems of the European states and the level of tax morale among the taxpayers of each state were compared.

An aggressive burden on tax policy has a negative influence on tax morale and the opposite policy helps to raise the tax morale. Researches also showed that the way the government treats a taxpayer has a consequence on the willingness of the taxpayer to pay taxes.

Investigated the differences in compliance between South Korea and Japan and found out that tax culture is one fundamental determinant of these differences, with Japan having a higher level of tax culture and thus a higher level of compliance. Hyun (2005).

Riahi-Belkaiou (2004) studied the link between tax morale and tax evasion analyzing data from 30 countries and showed that tax evasion is negatively related to economic freedom and high moral norms. Roth, Scholz, and Dryden-Witte (1989) argued that different cultural contexts which influence one's perception of events may drive one's attitude towards tax evasion.

According to the robust findings of Richardson (2006) derived from a 45-country analysis, non-economic factors have the strongest influence on tax evasion, i.e., lower levels of complexity and higher levels of fairness and tax morale lead to a decreased level of tax evasion across countries. Torgler and Schneider (2009) showed that in many countries tax morale and the high quality of societal institutions contribute to the reduction of the shadow economy. Alm and Torgler (2006) found a significant positive correlation between tax morale and trust (in the legal system and in the parliament), as well as a considerable negative correlation between tax morale and the size of shadow economy. Cummings, Martinez-Vasquez, McKee, and Torgler (2009) concluded that cross-cultural differences in tax compliance are due to perceptions of tax administration and taxpayers' assessment of government quality.

#### **2.4 Perception of political/government Accountability**

This is one of the psychological factors that influenced to the compliance behaviour.

Political stability of the ruling party of government in a country may play a significant role in determining tax evasion behaviour. For example, if an individual favour the current ruling government party, he might choose to be compliant because he believes that the government is trusted, efficient and equitable.

Logically, taxpayers, and especially those who pay high amounts of tax, will be sensitive to what the government spends their money on. Studies on the relationship between the specifics of actual government spending and tax compliance, particularly on tax evasion, are very limited.

Meanwhile, Roberts, Hite and Bradley (1994) also suggest that attitude to one's own tax evasion (tax ethics), and attitude to other people's tax evasion are important. It is also found that if taxpayers perceive that the government is expending on something considered unnecessary or unbeneficial to the development of the country, here-again, the taxpayers tend to avoid and attempt to evade.

Taxpayer's perceptions are potentially important in determining their compliance behaviour. In summary, the government should prudently spend taxpayers' money because the way in which the government spends the money produces different levels of compliance.

Many studies have shown that higher-educated people understand better the meaning of tax liabilities and the aim of governmental policies and, as a consequence, they Comply more (Schmölders, 1960; Song and Yarbrough, 1978; Spicer and Lundstedt, 1976). From the three aforementioned political determinants of tax

compliance, in the following we will draw attention on tax law complexity. People's understanding of tax law is an important factor which shapes their disposition to comply.

Results came much to the surprise of the researcher as respondents revealed a low level of knowledge and understanding of fiscal policy (Kirchler, 2007: 6). Poor tax knowledge and the uncertainty of the tax law offer authorities improper conditions in deciding to which extent taxpayers' behaviour is legal and where exactly is the boundary between right and wrong in the application of tax law provisions. By the same token, different studies support the idea that it is extremely difficult to delineate exactly a behaviour that is in line with "the letter of the law" (e.g., Marshall et al., 1998; Owens and Hamilton, 2004). Ironically, tax law is difficult to understand and gives birth to uncertainty not only for ordinary citizens but also for tax authorities. In 1959, Schmolders inquired different German politicians and finance representatives on their level of comprehension of fiscal policy issues.

Hasseldine & Hite (2003) examined whether attitudes toward the federal income tax system and the tax rebate vary by political party affiliation in the United States. Kim (2008) in his study on tax evasion in 50 countries each year illustrated these points and concluded that tax evasion is influenced by price control (positive direction), public service (positive), collected corporate tax (positive), GDP per capita (positive), tax system (positive) and the composition of government spending (positive).

Hasseldine and Hite (2003) concluded that firstly, political party affiliation has a significant impact on taxpayers' behaviour; secondly, identified the tax provision is to a specific party, the more favourably it will be received by members of that party relative to taxpayers with other political party affiliations; thirdly, the policy changes (the 2001 tax rebate) in this particular case tended to be viewed positively by taxpayers (i.e. creating an increase in taxpayers trust and in voluntary compliance), and those who did perceive it positively also tended to perceive the current system as more fair.

Lewis (1982) argued that when myths and misperceptions are replaced by knowledge, a change in attitudes towards taxation will occur even if the taxpayers' basic ideology and values remain unchanged and the tax law is unchanged. Suggests that attitudes should be examined for the degree to which they are a product of myth and misperception.

This Project provides an overview of the psychological factors for tax compliance that will support for researchers to examine the individual tax compliance. The psychological factors may influence with the attitude of people in the country.

### **3. Conclusion**

As per the above findings and issues hassling on taxation are highly importance and benefited to the people and government / tax authorities of any society and any country. This fact has established and confirmed by the reviewed literature, and it consequently justifies the great interests given to the subject of tax compliance by tax Authorities, governments, and academics. The review of literature of psychological factors has revealed that it is almost not possible to have one general model for studying compliance behaviour on psychological factors usually influence individuals as tax morale, social norms, equity and fairness, perception of government /political Accountability as attitude decision to comply ( or not) with tax payments. These factors characteristically differ from country to country and form one place to another. The related and existence models for studying tax compliance have individually collectively) provided nearby into understanding taxpayer compliance, such as psychological factors can make combination of models that paramount suits their environment and circumstances facing them.

A major conclusion that can be drawn from all the Statements stated by various researchers are that compliances influenced by both attitudinal and psychological factors. It is therefore significant that tax

administrators and academics pay huge attention into developing effective tax systems that will consider the possible psychological factors that individual believe when making the compliance decisions.

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