

# Relations Between Procedural Fairness, Tax Morale, Institutional Trust and Tax Evasion

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## Abstract

*The slippery slope model of forced or voluntary tax compliance might be seen as a reflection of the relationships between taxpayers and the tax authorities. Tax compliance depends on two dimensions: power of tax authorities and trust in the tax authorities (Kirchler, 2007). Trust in the authorities is the basis of civic commitment. The crucial role to create synergic climate and voluntary compliance seems to play procedural fairness. It was expected that procedural tax fairness directly affects trust in authority, tax morale and indirectly via tax morale affects tax compliance. Empirical support was found for these assumptions. The conclusions sum up the key issues discussed, policy implications and the limitation of the analysis.*

**Keywords:** Tax evasion; Tax morale; Procedural fairness; Trust.

## Introduction

Taxpayer's behaviour has been mainly studied as a problem of choice under uncertainty. The pure gamble model formulated by Allingham & Sandmo (1972) assumes a rational, self-interested risk-averse and amoral individual whose preferences are governed by the von Neumann–Morgenstern utility function. Tax evasion is risky because there is a certain probability that this activity will be discovered and punished. The results of surveys and experiments have mainly supported the crucial role of audit likelihood, legal sanctions severity, tax rate level and income level (e.g. Alm, Jackson & McKee, 1992; Anderhub et al., 2001; Baldry, 1987; Bergman & Nevarez, 2006; Carnes & Englebrecht, 1995; Clotfelter, 1983; Gërxhani & Schram, 2006; Slemrod, Blumenthal & Christian, 2001; Trivendi, Shehata & Lynn, 2003; Witte & Woodbury, 1985).

The Deterrence Model predicts that taxpayers are generally engaged in tax evasion, but the fact that compliance is far greater in practice than is commonly predicted in the model seems to indicate that taxpayers may also be motivated by a variety of other intrinsic factors. The model neglects the psychological and social aspects of the decision to evade taxes and only considers fiscal constraints. Therefore, the role played by moral and judicial factors in determining taxpayers' decisions focuses researchers' attention on this aspect. Erard & Feinstein (1994, p.74) point out: "One important reason why the conventional expected utility model of tax compliance overpredicts the prevalence and extent of tax evasion is that tax compliance behaviour is assumed to be motivated solely by financial considerations, whereas in reality many taxpayers are influenced by variety of other feelings, which we will call moral sentiments".

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In recent years the concept of tax morale has been used in much research. Although Feld & Frey (2002, p. 88-89) claim that „most studies treat tax morale as a black box without discussing or even considering how it might arise or being part of it might be maintained. It is usually perceived as being part of the meta-preferences of taxpayers and used as a residuum in the analysis capturing unknown influences on tax evasion”. The term tax morale was introduced in 1960 by Schmöders and was defined as the “attitude of a group or the whole population of taxpayers regarding the question of accomplishment or neglect of their tax duties” (Schmöders, 1960, apud Kirchler, 2007). Nowadays tax morale is considered as an internalized obligation (Feld & Frey, 2005) or intrinsic motivation to pay one’s taxes (Alm & Torgler, 2006). Taxpayers will pay their taxes because they believe that it is morally right to do so, even though the probability of being caught cheating is low. Alm & Torgler (2006) with data sets from World Value Survey conducted a cross-country comparison of tax morale. Researchers have included to analysis data from the United States and 14 European countries with broadly similar levels of economic development and systems of taxation. The study revealed that individuals in the United States have the highest tax morale of all the countries investigated, followed by respondents in Switzerland, Austria, Denmark, Sweden and Spain. The cross-country comparison conducted by Alm & Torgler (2006) is based on a single-item measure- only one question was used to assess the level of tax morale. The authors were aware that a single-item measure has some disadvantages and should be treated with some caution because “tax morale is likely to be a multi-dimensional concept which may require a multi-item measurement tool” (Alm & Torgler, 2006, p. 229). The crucial question is how respondents understand the term “cheating on tax”.

In most countries there is legal distinction between tax avoidance and tax evasion. The former refers to attempts to reduce tax liability through legal means such as loopholes in the law and creative designing of one’s own income or deduction (Kirchler, 2007). The latter refers to deliberate acts of under-reporting income or claiming overdue deductions (Hessing et al., 1989). The study conducted by Kirchler, Maciejovsky & Schneider (2003) on the social representation of tax avoidance and tax evasion has shown that ordinary taxpayers clearly distinguish between these two forms of non-compliance. Tax avoidance was associated with an intention to save taxes, through legal methods and cleverness. In turn, tax evasion was associated with illegal behaviour, with criminal offence, with punishment, penalties and with intentional errors. In general terms, tax avoidance was perceived as legal and moral, while tax evasion was perceived as both illegal and immoral.

Tax morale directly and positively relates to high degree of tax compliance. Tax morale can explain more than 20 percent of the total variance of the variable’s size of shadow economy (Alm & Torgler, 2006). Wenzel (2005) yielded some evidence for bi-directional causality between tax morale and tax compliance: not only does tax morale influence tax compliance, but it can adapt to rationalize and justify one’s engagement in tax evasion.

Michael Wenzel (2004; 2005) distinguishes between two types of moral tax standards: social standards (norms of social groups or community) and personal standards (own moral norms). The relations between tax personal norms and taxpayers’ behaviour are immediate: the stronger (weaker) personal standards, the greater (smaller) tax compliance (Alm & Torgler, 2006; Bosco & Mittone, 1997; Braithwaite & Ahmed, 2005; Cummings et al., 2009; Dell’Anno, 2009; Eisenhauer, 2008; Feld & Frey, 2002; Frey, 2003; Henderson & Kaplan, 2005; Lewis, 1982; Torgler, 2003; 2004; 2005; Traxler, 2010; Wenzel, 2004; 2005). Relationships between tax social norms and tax compliance are moderated by the degree of identification with the social group. Rigidity of social norms imposes additional costs on tax evaders: fear of exclusion and stigmatization. The dual nature of the risk (financial and social) acts as a restraint from evading taxes. This is especially noticeable in people who strongly identify with the state and for whom the national identity is extremely important (Konrad & Qari, 2009; Wenzel, 2004). Perceived widespread tax evasion can also lead to a loss in social standing of one’s position in the community (Elffers, Robben & Hessing, 1992; Webley, Robben & Morris, 1988; Webley, Cole & Eidjar, 2001; Weigel, Hessing & Elffers, 1987; Wenzel, 2005). The permissiveness norms and behaviour of others might encourage the individual to ignore and disregard his/her own strict beliefs. It might also justify any

subsequent behaviour. Belief in widespread tax evasion might call into question the rationality behind the state obligations. Perceived social norms may encourage honest tax payment, or serve as a rationalization of tax evasion (Alm, McClelland & Schulze, 1999; Blanthorne & Kaplan, 2008; Bobek, Roberts & Sweeney, 2007; Wenzel, 2005).

Tax morale refers to a voluntary compliance. Voluntary compliance is inherent in people who do not need external stimulus to comply. They comply due to feelings of moral obligation as members of the community. This kind of compliance might be expected in a synergistic tax climate. Kirchler, Hoelzl & Wahl (2008) distinguished between synergistic and antagonistic tax climates. In the former, taxpayers and tax authorities work together towards a common goal and their mutual relations might be seen as the expression of a “service and client” philosophy as opposed to an antagonistic climate, where taxpayers and tax authorities work against each other in a social distance, and their relations are similar to that of “cops and robbers”. Two basic factors shape voluntary compliance: tax morale and trust in the authorities. Voluntary compliance in the synergistic climate is linked to a high level of trust in the tax authorities based on the nature of relationships between the tax authorities and the citizens. Voluntary compliance is encouraged through fair procedures science, this helps to build and maintain trust: if people believe that the authority is supportive and respectful, they will trust the authority’s motive and thus, work towards a common goal. Hence, it is expected that procedural fairness directly affects trust in authorities and indirectly tax compliance (Hypothesis 1).

Furthermore, procedural fairness has a significant impact on the psychological legitimization of the state whereas the state’s legal legitimacy does not guarantee this. Individuals and groups judge institutions from the perspective of targets and how these are realized. Neutrality, trust, respect not only lead to a decrease in social distance between citizens and representatives of the state, but also provide a psychological legitimization for executive and legislative authorities (Tyler, 1997). The model of group values (Lind & Tyler, 1988), a relational model (Tyler & Lind, 1992) and a model of involvement in the group (Blader & Tyler, 2009; Tyler & Blader, 2000) assume that the interest into procedural fairness is connected with symbolic communication concerning the group membership. Procedural justice provides individuals with cognitive information about how much they are valued as an individual and as members of particular groups. Tax administration, which offers people a possibility to express opinions, demonstrates an understanding, kindness and trust, thus allowing citizens to feel a sense of pride and self-regard as taxpayers. Procedural fairness intensifies cooperation as it strengthens the process of including others in self (De Cremer, Tyler & den Ouden, 2005). The self-expansion theory assumes that the process of including has a significant influence on behaviour (Aron & McLaughlin-Volpe, 2001). If a partner of an interaction is thought to be a part of self, own and other sources are treated as exchangeable and aims of the others might become personal ones. The individual develops a sense of responsibility towards the community, and is mindful of the consequences of any actions they perform. Tax authorities need to be regarded as supportive, respectful and impartial if they are to be included in the “Self” category whereby they are able to encourage cooperation. This is particularly strong if there is a high level of trust between the individual and the authorities (De Cremer & Stouten, 2003).

Assessment of procedural fairness is depended on decision quality and treatment quality. Perceived fairness of procedures is high when decisions are made carefully in an unbiased consistent manner, allowing the individual an opportunity to express individual opinion. Fair practice guarantees fair outcomes in the long term, and are sources of symbolic message - they communicate that one is a valued and respected as a member of the collective (Tyler & Lind, 1992; Tyler & Blader, 2000). The manner in which taxpayers receive notification, including the content and form of the letter explicitly reveals the character of the mutual relations between tax authorities and taxpayers. A formal announcement with strict sanctions classifies the individual as a suspect and casts them automatically into a swindler’s role. The sense of being under constant control with its implied lack of trust negatively influence the intrinsic motivation to pay taxes. Explicit deterrents rather than a strategy of providing additional information results in individuals developing a pragmatic attitude towards the payment of tax

as predicted in the deterrence model (Feld & Frey, 2002; Murphy, 2004; Wenzel, 2006). Respectful treatment, and evident trust from the tax authorities, as well as the opportunity to express one's opinion might increase an intrinsic motivation to pay taxes. The nature of decision making and the quality of relationships between tax authorities and taxpayers should significantly influence tax morale, and, ultimately, tax compliance. It is expected that procedural fairness directly affects tax morale and, indirectly via tax morale, affects tax compliance (Hypothesis 2).

## Method

### Sample and procedure

The study was conducted on a group of 558 adult Polish taxpayers; cases were dropped list-wise when data was missing. This provided the final sample of 485 individuals for the analysis (a response rate: 87 %). The sample consisted of 67% of women and 33% of men. 47% were younger than 30 years, 48% were between 30 and 49 years, and 6% were older than 50 years of age. Of all the respondents, 49% had received a secondary education, and 51% had a master degree. About 73% of the respondents were employees, and 27% were employers.

The study was carried out during lectures devoted social sciences (part-time studies) and in cooperation with the tax advisory authority, which helps prepare tax returns, especially for employers. Each subject received a sealed questionnaire and information letter about the objectives of the study and the confidentiality of the data. Sealed envelopes with the completed material were put into a box in the lecture room or into a box in the tax advisory offices. The main purpose of this procedure was to guarantee the anonymity of the participants due to confidential nature of data dealing as it does with the payment of taxes.

### Measures

Perception of the tax procedural fairness was assessed with the Procedural Fairness Tax Scale (PFTS) based on the measures proposed by Murphy (2003), Verboon & van Dijke (2011), De Cremer, Tyler & Ouden (2005), and Blader & Tyler (2009). The scale elaborated by Kristina Murphy is based on the work of Tyler and examines three issues: confidence in tax administration, the impartiality of the tax administration and the respect shown by the tax administration to taxpayers. The scale proposed by Peter Verboon and Marius van Dijke included items related to the treatment of taxpayers and method of decision-making carried out by the tax administration. These scales and methods measuring organizational procedural fairness (De Cremer, Tyler & Ouden, 2005; Blader & Tyler, 2009) were used to encourage an own approach. There were generated 25 statements, some of which were concerned with the process of decision making by the tax administration and the opportunity for participation in that process, as well as others items related to information provided to taxpayers and some items involving relations between the tax authorities and taxpayers. To analyze the factor structure of the PFTS, an exploratory factor analysis with Varimax rotation was conducted. The analysis has identified two subscales, named decision fairness (5 items), and treatment fairness (8 items). Two factor solution explained 59.89% of the variance, all items reached loadings above 0.50. The final version of the questionnaire contains 13 items in a self-report format that uses a Likert-type scale from 1 (completely disagree) to 7 (completely agree) (Appendix A). The internal reliability of the PFTS was found to be very good with a Cronbach's alpha score 0.88 for subscale of Decisions Fairness, and a score 0.85 for subscale of Treatment Fairness. Answers to the items in each scale were averaged to obtain indexes for decision fairness and relations fairness.

Tax morale was assessed on The Personal Tax Morale Scale (PTMS) based on the measures proposed by Wenzel (2004; 2005) and Blanthorne & Kaplan (2008). Two kinds of tax evasion are estimated in Wenzel's scale: intentionally hiding income in cash and overstating tax deductions. In turn, the method used by Blanthorne & Kaplan focuses on only a one type of behaviour - underreporting income in the tax return. The Personal Tax Morale Scale included all three types intentionally tax evasion: underreporting income general, overstating tax deductions and underreporting income by receiving cash without paying taxes. The exploratory

factor analysis elicited a one factor solution, which explained 51.89% of variance, all items reached loadings above 0.60. The PTMS contains 6 items in a self-report format that uses a Likert-type scale from 1 (completely disagree) to 7 (completely agree) (Appendix A). Internal reliability for the PTMS was sufficient with Cronbach’s alpha 0.82. Answers to the six items of scale were averaged to obtain an index of personal tax morale.

Institutional trust (Fukuyama, 1997) was measured with four items estimated by the Likert-type scale from 1 (completely disagree) to 7 (completely agree). Besides examining trust in government and parliament (Frey & Torgler, 2007; Torgler & Schneider, 2007; Torgler, 2011) two other public agents were introduced: public administration and tax administration. The exploratory factor analysis has identified one factor solution, accountable for 51.33% of variance; all items reached loadings above 0.70. The internal reliability of the scale was sufficient with Cronbach’s alpha 0.84. An average score was the index for institutional trust.

To estimate tax evasion indirect and direct methods have been used. The former used macroeconomic data, the latter data was obtained from taxpayers in the form of official documents (tax returns) and more often survey data. As in Braithwaite (2001a; 2001b; 2003), Weigel, Hessing & Elffers (1987), and Wenzel (2002; 2005) tax evasion was examined directly in the conjunction with survey. The following three items were used: 1) In the past I have deducted more money than is allowed, 2) In the past, I have underreported my income, 3) In the past, I have obtained cash income and failed to this to the tax office (*1- yes, 0- no*). The internal reliability of the scale was very good with Cronbach’s alpha 0.94. The sum score over the three items was taken as an index for tax evasion.

**Results**

Table 1 shows the descriptive statistics of the variables and bivariate relationships among them. The analysis supported significant, if weak, negative correlations between tax morale, the fairness of the decision making process and the tax evasion. Those who do not believe that non-payment of taxes is a trivial offence, and not acceptable underreporting income or overstating tax deduction, were less likely to report non-compliance ( $r = - 0.22, p < 0.01$ ). The correlation between an assessment of the decision making process and tax evasion was weak yet significant ( $r = - 0.19, p < 0.01$ ), whereas assessment of treatment and tax evasion was non-significant ( $r = - 0.15, p > 0.01$ ). The relationships between institutional trust ( $r = 0.34, p < 0.01$ ;  $r = 0.45, p < 0.01$ ), tax morale ( $r = 0.31, p < 0.01$ ;  $r = 0.31, p < 0.01$ ) and both aspects of procedural fairness were positive and moderate.

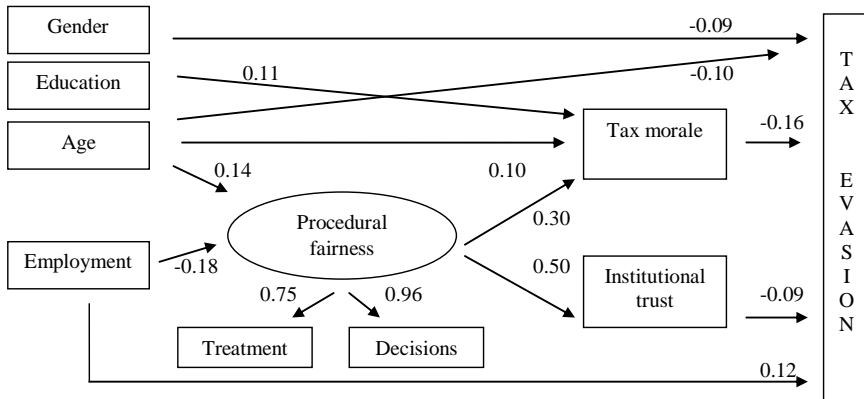
**Table 1:** *Descriptive statistic of variables (N=485)*

	M	SD	TE	TM	IT	PF:D
Tax evasion	0.99	1.25				
Tax morale	3.41	1.32	-0.22*			
Institutional trust	3.14	1.27	-0.16	0.21*		
Procedural Fairness: Decision	3.58	1.09	-0.19*	0.31*	0.34*	
Procedural Fairness: Treatment	3.14	1.19	-0.15	0.31*	0.45*	0.71*

Table presents means, standard deviations and correlations between the study variables

\*  $p < 0.01$  with Bonferroni correction

In order to examine in detail the directed and indirect relationships between procedural fairness, institutional trust, tax morale and tax evasion, a structural equation model using Analysis of Moment Structures (AMOS) was constructed. The demographic control variables were also included into the analysis. The final model, which provided the best fit to the data, is presented in Figure 1.



**Figure 1:** Structural equation model demonstrating relations between procedural fairness, institutional trust, tax morale, demographic variables and tax evasion

Figure 1 shows the standardized model as estimated by AMOS. The observed variables are displayed in a rectangle, and the latent construct is displayed in an oval. The goodness of fit indicates for the structural equation model testified that final model provided an excellent fit to data:  $\chi^2_{(20)}=26.194$ ,  $p=0.160$ ;  $CMIN/DF=1.310$ ;  $NFI=0.926$ ;  $CFI=0.981$ ;  $RMSEA=0.025$ . Furthermore, modification indicates that addition or deletion of any further pathways did not improve the model.

In the final model, empirical support was found for the assumption that procedural fairness affects tax compliance via trust in authorities and tax morale. As can be seen in Figure 1, procedural fairness was positively related to institutional trust ( $\beta = 0.50$ ,  $p < 0.001$ ), and tax morale ( $\beta = 0.30$ ,  $p < 0.001$ ); the later one to less extent. Perceived procedural tax fairness was based on the assessment of decision making process ( $\beta = 0.96$ ,  $p < 0.001$ ), and to a lesser extent, the evaluation of relations with tax authorities ( $\beta = 0.75$ ,  $p < 0.001$ ). Two demographic variables had a significant impact on procedural tax fairness: age ( $\beta = 0.14$ ,  $p < 0.001$ ) and employment ( $\beta = -0.18$ ,  $p < 0.001$ ). Older taxpayers and employees estimated fairness of decisions and fairness of treatment by tax authorities more negatively than taxpayers under forty years old and employees.

Age ( $\beta = -0.10$ ,  $p < 0.01$ ) and employment ( $\beta = 0.12$ ,  $p < 0.01$ ) also affected tax noncompliance. Older taxpayers and employees were less likely to be actively involved in any tax evasion. As expected, tax morale ( $\beta = -0.16$ ,  $p < 0.001$ ) and institutional trust ( $\beta = -0.09$ ,  $p < 0.01$ ) directly affected tax evasion. Although procedural fairness was not found to affect tax behaviour directly, its impact on tax morale and trust in authorities affected tax evasion implicitly ( $\beta = -0.09$ ,  $p < 0.05$ ). The total standardized indirect effect of procedural fairness on tax evasion was  $-0.10$ , and was manifested mainly via tax morale. When procedural fairness increased by 1 standard deviation, tax evasion decreased by 0.10 standard deviations.

Gender had a significant influence on tax evasion ( $\beta = -0.09$ ,  $p < 0.05$ ): male participants were more likely to cheat on taxes than their female counterparts. The results of the study showed that age ( $\beta=0.10$ ,  $p< 0.05$ ) and education ( $\beta=0.11$ ,  $p< 0.05$ ) had a significant impact on tax morale. These findings suggest that young taxpayers, with secondary education are more prone to justify overspending and underreporting income in the tax returns than older taxpayers with tertiary education.

## Conclusions

Nowadays, the most popular instrument forcing citizens to pay taxes are stringent enforcement strategies. Deterrent policy reflects domination of the rational choice model, which assumes that people are motivated entirely by profit seeking. Moreover, citizens comply with authority

as a result of strict sanctions. However, these practices might sometimes be counterproductive and induce reactance, especially when are perceived as illegitimate. Harsh enforcement of these laws, could also lead to alienation, which then decreases the taxpayers' willingness to cooperate with the tax authorities. Indeed, taxpayers are motivated not just by a concern to maximize their own well-being, but also by a sense of civic duty- concern for the state or the country (Frey, 1997). Orviska & Hudson (2002) demonstrate that civic duty affects tax evasion through its impact on tax morale - a great sense of civic duty increases disapproval of underreporting income on the tax return.

In Kirchler's view (2007) trust is the foundation of civic commitment. In a slippery slope model, paying taxes on a forced or a voluntary basis, reflects the relationships between taxpayers and tax collectors. Two kind of philosophy are laying under the responsive model of regulation (Braithwaite, 2003). The first, which may be called "cops and robbers" casts taxpayers as potential thieves and determines a constrained taxpayers' cooperation with the representatives of official authorities. The second, on the other hand, defines the relationship as "contractors and customers". This id bases on internal standards and on a sense of the citizen's duty manifested as voluntary cooperation with state authorities. In both models, however, the relationships between taxpayer and tax administration have a fundamental meaning. The results of this study demonstrate that procedural fairness has a significant influence on institutional trust and tax morale. Factors such as a supportive approach to taxpayers, respect, impartiality, reliability, solidity as well as the opportunity to appeal against the tax administration's decisions - improve trust in the tax authorities and a sense of a moral obligation to the state. The results obtained confirm assumption regarding the 'slippery slope' model.

Methods of limiting the phenomenon of tax evasion are broadly discussed in the literature. Actions, based on the assumptions of the Deterrence Model, concentrate on such issues as: tax charges, the selection of taxpayers, and effectiveness of tax audit control and punishment policy. Public authority has two approaches through which they can have an impact on taxpayers' behavior - by economic factors and by tax morale and procedural tax fairness. Research results outcomes show the direction of tax administration's actions. The activity should concentrate on campaigns that improve citizens' tax standards. Furthermore, the government should propagate educational politics in order to emphasize tax compliance as ethical behaviour, as a duty towards society and state.

Enhancing procedural tax fairness is the next step in improving tax discipline. This is dependent on the strength of the relationship between tax authorities and taxpayers as well as on the nature of the decisions made by the tax authority. In order to build and maintain perceived procedural justice, it is essential to: implement standards for tax administration, systematically examine the merit of the action taken by the tax authorities, conduct interpersonal skills trainings and introduce a code of conduct for taxpayers. All of these activities help to improve the moral stands towards tax. The results obtained demonstrate the value of perceived tax fairness: the stronger belief in procedural fairness, the lower acceptance of tax frauds and greater trust in tax authorities.

Although the outcome of the research allow for better understanding of taxpayers' behaviour, they are also thought to bring limits concerning research groups. First of all, the research group was not representative. Consequently, it is not possible to generalize on these results. The total number of participants was higher than the size of the research group; data sets from part of people were excluded from statistical analysis due to insufficient number of answers, especially concerning tax evasion. It is easy to predict that the participants' reluctance and the fact that they did not answer the questions on tax evasion, was due to a desire to hide facts. Thus, considering all the data gathered could have been altered a capacity and a link between variables.

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