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Trust and power as determinants of tax compliance: Testing the assumptions of the slippery slope framework in Austria, Hungary, Romania and Russia

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ABSTRACT

The slippery slope framework of tax compliance integrates different determinants of tax compliance and assigns them to one of two major dimensions. Accordingly, tax compliance depends on the factors perceived trust in the authorities and perceived power of the authorities, but trust on the one hand fosters voluntary compliance whereas power on the other hand leads to enforced compliance. The present study tested these main assumptions of the slippery slope framework in four European countries differing in terms of cultural and economic settings (Austria, Hungary, Romania and Russia) by presenting participants with different scenarios of trust and power. As predicted, the highest level of intended tax compliance and the lowest level of tax evasion were found in conditions of high trust and high power. In addition, participants in conditions of high trust indicate more voluntary compliance just as participants in conditions of high power indicate higher enforced compliance. The present results support the assumptions of the slippery slope framework and confirm the role of trust and power as important determinants of tax compliance.

1. Introduction

Taxation, tax evasion, and the fighting of tax havens can be found on top of political agendas throughout the world. Political campaigns often focus on eliminating loopholes in national tax laws and negotiating bilateral tax agreements. In dealing with tax compliance, this approach might be regarded as deficit oriented, since tax revenues are not increased by improving compliance, but by making tax evasion more difficult. Early studies in the field clearly suggest that economic factors like detection probability and severity of penalties are the most prominent determinants of tax compliance (e.g., Allingham & Sandmo, 1972). However, a number of literature reviews report inconsistent findings on the relationship between audit

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probability, fines, and tax compliance (Andreoni, Erard, & Feinstein, 1998; Fischer, Wartick, & Mark, 1992) and if these factors were the only determinants of tax compliance, tax evasion rates should be way higher than actually observed (Alm, 1991). Thus, in recent years trust in governmental authorities, as well as tax morale and motivational postures have been investigated with regard to their influence on tax evasion (e.g., Braithwaite, 2003; Coleman, 1996; Lago-Peñas & Lago-Peñas, 2010; Lavoie, 2009; Torgler, 2005).

1.1. Tax evasion, intended tax compliance, and tax morale

The term tax evasion refers to the deliberate act of breaking the law in order to reduce taxes (Elffers, Weigel, & Hessing, 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 and fines (Kirchler, 2007). Studies show that trust is negatively related to tax evasion, i.e., low trust in tax authorities is correlated with high levels of tax evasion (Richardson, 2008). Furthermore, a significant influence of power under the form of audits and fines on tax evasion is found in many studies (e.g., Allingham & Sandmo, 1972; Andreoni et al., 1998; Fischer et al., 1992).

Intended tax compliance assesses citizens' disposition to pay taxes at a deliberate level. The literature on the effects of trust on intended tax compliance contains several studies which support the idea that trust in authorities positively influences it (e.g., Scholz & Lubell, 1998; Torgler, 2003). More specifically, Feld and Frey (2007) show the importance of the relationship between taxpayers and tax authorities, emphasizing that mutual respect increases tax compliance level. Hammar, Jagers, and Nordblom (2009) note that tax compliance is fostered by the trustworthiness of policymakers. Focusing on the role of social variables in tax compliance, van Dijke and Verboon (2010) observe a link between trust and tax compliance, through procedural fairness. Low trust in tax authorities determines taxpayers to pay particular attention to the fairness with which authorities enact procedures. Thus, tax compliance increases only in a climate of high trust in which authorities act fair towards taxpayers. Power of authorities impacts differently on intended tax compliance, i.e., it has positive, negative, or no effect (for an overview see Kirchler, Muehlbacher, Kastlunger, & Wahl, 2010).

The term tax morale is defined as "the attitude of a group or the whole population of taxpayers regarding the question of accomplishment or neglect of their tax duties; it is anchored in citizens' tax mentality and in their consciousness to be citizens, which is the base of their inner acceptance of tax duties and acknowledgment of the sovereignty of the state" (Schmoelders, 1960, p. 97). Some researchers define tax morale as the intrinsic motivation to pay taxes (Alm & Torgler, 2006; Feld & Frey, 2002) or "internalized obligation to pay tax" (Braithwaite & Ahmed, 2005), while others link it with "civic duty" (Orviska & Hudson, 2002) or tax ethics (Torgler & Murphy, 2004). Frey (2003) argues that taxpayers are endowed with a considerable amount of civic virtue and tax morale, which shapes their tax compliance behavior when integrated in the general context of the relationship between taxpayers and tax authorities. 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). Torgler (2003) analyzes compliance behavior in transition countries and concludes that trust in the legal system and the government increases tax morale. Frey (2003) argues that tax morale decreases when taxpayers have little trust in authorities and are treated with no respect. 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.

1.2. Cross-cultural research on tax compliance and tax morale

The necessity of cross-cultural studies for understanding differences in tax behavior is emphasized by several authors. Hyun (2005) 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. 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. Riahi-Belkaoiu (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. 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. 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. 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. 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.

1.3. The slippery slope framework

In the field of research on tax behavior, the slippery slope framework (Kirchler, Hoelzl, & Wahl, 2008) is an attempt to integrate economic and psychological determinants in order to explain tax compliance. Since, as pointed out before, purely economic factors such as audit rates and fines have shown inconsistent effects on tax payments, the idea that taxpayers try