Analysis of Compliance Behaviour and Encouraging Tax Compliance

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Abstract
The aim of the paper is to analyse attitudes of taxpayers towards tax compliance, describe strategies to increase voluntary tax compliance and proposed instruments within the individual strategies. Assessment of the tax reliability of taxpayers is the current trend applied in the tax policy making of EU Member States. Taxpayers may be categorized on the basis of their attitudes towards tax compliance using management of the tax compliance risks. Segmenting taxpayers in the compliance pyramid can help tax authorities to differentiate the approach towards taxpayers. A targeted selection of taxpayers increases the effectiveness of tax audits and helps to detect tax evasion. A desired goal is to achieve the voluntary compliance and to increase the efficiency of tax collection. The results of the questionnaire survey support the hypothesis that tax morale plays a significant role in a decision-making of taxpayers.

Key Words: Tax policy, tax compliance, tax reliability index
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1. Introduction

It is very important to understand a decision-making of taxpayer whether to comply with the tax law or not. Empirical evidence shows that a wide range of factors, including economic factors, personal and social norms, attitudes of taxpayers towards the state and taxation, motivation to comply or trust in tax authorities or public institutions, may affect the individual compliance decision (Braithwaite, 2003; Torgler, 2003, Kirchler, 2007).

Taxpayers who have higher tax morale put more emphasis on social reputation, personal standards and attitudes. On the opposite side, taxpayers with lower tax morale are more influenced by external factors, such as corruption, the probability of being audited or sanctions and benefits associated with illegal behaviour.

Taxpayers’ perception of tax authorities and building mutual trust between them plays an important role in the effective tax collection as well. The recommendations in this regard are focused on the new alternative pro-client approaches to the application of taxpayers’ rights.

An important part of improving taxpayers’ relationships with the tax authorities are concepts aimed at clarifying objectives of the state and procedures of tax authorities in the tax area, creating taxpayers’ positive attitudes towards tax collection, as well as increasing perception of fairness in tax collection and the use of collected tax receipts. These concepts were applied by Australia or the US with the positive results. For example, ‘The Taxpayers’ charter’, which was introduced by the Australian Taxation Office (ATO), established collaboration of taxpayers and tax authority on the basis of thirteen well-defined rules and standards. Mutual respect for the rights and obligations of both parties has a major impact on a fairer and more efficient tax collection.

2. Literature Review

The standard model of tax compliance behaviour is based on Allingham and Sandmo model (1972). It assumes that a taxpayer makes a rational choice to be compliant or non-compliant having considered these options on the basis of the cost-benefit analysis. People comply when the costs of evasion outweigh the benefits of evasion and vice-versa. This model shows that the compliance level increases as the audit probability (the risk of detection) and the penalty rate (the punishment) increases. The model is also referred as the economic deterrence model and appears to have been very influential for enforcement practice of tax authorities (OECD, 2010).

Deterrence should positively influence taxpayer compliance (Slemrod, Blumenthal & Christian, 2001). The empirical evidence is mixed. OECD (2010) discusses several studies that examine the role of deterrence. Some findings are expected such as the positive impact of audits and penalties on tax compliance (Blackwell, 2007). However, the effects are rather weak. The experimental research confirms that the standard model alone is insufficient in explaining observed tax evasion behaviour and level of non-compliance in a society (Torgler, 2002).
explanation is that people tend to overestimate the probability of being audited and the sanctions that might follow (Reeson & Dunstall, 2009).

Alm, McClelland & Schulze (1992) pointed out that there are numerous factors other than detection and punishment (economic factors) that influence the decision of taxpayers to pay taxes. Murphy (2004) stated that if taxpayers do not trust the tax administration to collect tax fairly, non-compliance will increase. Recent studies of tax compliance (Kirchler, 2007; Feld & Frey, 2007; OECD, 2010) mainly focus on sociological and psychological factors (behavioral norms) that affect taxpayer’s behaviour. The attention is put mainly at the role of personal and social norms and fairness and trust in tax authorities (Feld & Frey, 2002; Kirchler, Hoelzl & Wahl, 2008). Torgler (2002) supported the idea that tax morale may play a key role in compliance behaviour.

Research showed that personal moral standards, attitudes and religious beliefs are closely related to the taxpayer’s conscience and behaviour. Conscience may affect tax compliance if tax evasion is in the conflict with the law and with the behaviour of honest taxpayers. It generates a sense of guilt for the tax evader (Eisenhauer, 2006; Eisenhauer, 2008).

Established social norms and cooperation of a certain group of people may have an impact on tax compliance. The unlawfulness of tax evasion logically forces tax evaders to hide their activity from the public view. Strategies by which tax evaders carry out fraud are not spread publicly, but they are exchanged in a circle of people who trust each other. Exchange of information and experience within a group of taxpayers may affect the perception of risk as well as tax morale (Hashimzade et al., 2014).

The social convention may be also influenced by the interaction of relationships between individuals within a given social group. Behaviour of people in a group may affect the decision making of other people in the group. For example, if there are people who do no pay taxes, it can reduce tax compliance of other people in the group (Lefebvre et al., 2015). Understanding the behaviour of these entities can help the state to set out its tax policy.

3. Methodology

3.1 Factors Influencing Tax Compliance and Compliance Pyramid

Tax compliance is defined mainly as the willingness of taxpayer to pay taxes. It has a broad meaning (Walsh, 2012). Tax compliance covers filing compliance (filing returns on time), reporting compliance (reporting incomes correctly) and payment compliance (paying tax due on time). It can be viewed of whether such compliance is achieved voluntarily or corrected by enforcement actions carried out by tax authorities.

Theoretical and empirical studies reported that tax compliance behaviour is as complex as taxpayer’s personality (Bătrâncean, 2012). It is motivated by various factors. The research literature identified two broad approaches to tax compliance. The first, economic approach is
based on the economic rationality and economic factors. The second, behavioural approach is based mainly on psychological and social norms.

The standard economic model of tax compliance behaviour focuses on the influence of economic factors on compliance behaviour (Allingham & Sandmo, 1972; Srinivasan, 1973; Slemrod, Blumenthal & Christian, 2001). It assumes there are four different determinants that shape taxpayers’ behaviour: audit probability, fines, tax rates and income. Andreoni, Erard & Feinstein (1998) pointed out that psychological (e.g., guilt, regret, sense of duty), demographic, social, and moral factors should be integrated into the standard economic models of tax evasion. Braithwaite (2003) identified five motivational postures which shape tax compliance behaviour: commitment (taxpayers who are willing to do the right thing), capture (try to, but don’t always succeed), resistance (don’t want to comply), disengagement (have decided not to comply) and game-playing (enjoy the challenge of winning against the tax authority).

In 2004, OECD introduced BISEP model which is used for identifying factors that influence taxpayers’ behaviour and their attitudes to compliance, such as: business, industry, sociological, economic and political factors (OECD, 2004).

Furthermore, OECD identified five determinants of taxpayers’ compliance behaviour (OECD, 2010), such as: deterrence (e.g. audits, perceived risk of detection and severity of sanctions), norms (personal and social), opportunity (to comply and not to comply), fairness (related to outcome and procedures) and trust (both in the government or tax authority and in other taxpayers), and economic factors (general economic factors, factors related to the business or industry and amount of tax due).

The traditional role of tax administration focuses on detecting and correcting errors after they have been made. However, there is an increasing trend in many EU countries to develop more pro-active approaches to prevent errors before they occur. This is linked to better understanding taxpayer behaviour and motivations and preferring pro-client (‘service and client’) approach before traditional reactive approaches based on sanctions (Kirchler, 2007; Torgler, 2011).

The tax administrators can achieve more effective tax collection by assessing the tax reliability of individual taxpayers. Taxpayers may be categorized according to their attitudes towards fulfilling their tax obligations. Classification of taxpayers into groups is based on the risk management approaches. A suitable model for assessing tax reliability of taxpayers is the compliance pyramid (see figure 1), on the basis of which taxpayers may be segmented in the categories according to the risk associated with the collection of taxes. This model provides a way to better understand what motivates people to comply or not comply. It recognizes that taxpayers are not a homogenous group and that their attitudes can change over time. Finally, it provides tax authorities with information on the factors that influence different compliance
behaviour and helps them to decide what interventions (strategies) to make (Russell, 2010). This model is successfully used in Australia, New Zealand, Austria or Denmark.

**Figure 1: Tax Compliance Pyramid**

![Tax Compliance Pyramid](image)


The left side of the tax compliance pyramid reflects the different taxpayer attitudes to tax compliance ranging from “willingly compliant” to “purposely non-compliant”. However, there are different degrees of non-compliance. The corresponding compliance strategy that best responds to each particular attitude is on the right side. Instruments to fill particular strategies can be different from preventive to enhancement tools. It is clear that strategies based only on repressive instruments will fail. The aim of the tax authorities is to influence as many taxpayers as possible to move down the pyramid and to achieve voluntary compliance.

### 3.2 Research Question and Data

At the University of Economics in Bratislava, we conducted a direct structured questionnaire survey on a sample of 247 respondents (students), of which 166 were women and 81 men (Schultzová, Rabatinová & Benko, 2017). The survey focused on examining the attitudes of respondents to tax fraud. Its main purpose was to determine the level of tax discipline of respondents and the degree of risk aversion to tax evasion. We supposed that tax morale, i. e. moral duty to pay taxes plays a significant role in compliance behaviour of the taxpayer. In addition, we assumed that individual’s tax morale is high.

The selected method of research has some shortcomings. It may, to some extent, distort the real attitude of respondents to the phenomenon examined. It is related in particular to the subjective self-perception of taxpayer as an honest person and the presentation of such attitude.
to the public. From this point of view, self-reported tax compliance could be higher than in reality.

4. Results and Discussion

The analysis of the data from the structured questionnaire survey confirmed that the majority of respondents showed a high level of tax morale. This fact was not influenced by the perception of the effectiveness of repressive instruments used by the tax authorities.

The results of the survey are as follows:

- 86% of all respondents consider repressive tools to be not effective, of which 85% are female respondents and 87% are male respondents,
- 79% of all respondents (85% of women and 68% of men) prefer fulfilling tax obligations in accordance with the law,
- 82% of all respondents (88% of women and 69% of men) would refuse to participate in tax fraud if they had the opportunity,
- 20% of all respondents are willing to cooperate with tax authorities in detecting tax fraud.

Figure 2: Attitudes of Respondents towards Tax Fraud

The survey confirmed that women have a higher propensity to tax compliance than men, i.e. they are more tax compliant with a higher level of tax morale. It can be explained mainly by these factors: the propensity for risk is lower among women (men are willing to take a higher risk) and women also tend to over-estimate the probability of detection and punishment.

The survey revealed that respondents perceive tax fraud as being more negative than adjustment of the tax base. The most frequent reason was the reputation of taxpayer and the higher perceived risk of detection and punishment. The low interest of respondents to cooperate with tax authorities in order to detect tax fraud was justified by corruption and mistrust in law enforcement.
5. Conclusions and Recommendations

A diversity of taxpayers confirms the need for tax authorities to implement the new approaches to taxpayers. Tax authorities should build the status of a trustworthy partner to assist taxpayers in meeting their obligations.

Tax authorities can achieve a more efficient tax collection by assessing tax reliability of the individual taxpayers. Based on the degree of reliability, tax authorities may consider an adequate strategy to taxpayer that will effectively increase tax collection. A suitable starting model for the evaluation of taxpayers may the tax compliance pyramid. On the basis of taxpayers’ segmentation into different categories it allows to create and apply specific treatment strategies, depending on the type of taxpayer. In practice, more sophisticated tools such as “data mining” are used in order to detect suspicious behaviour patterns and identify risk entities and transactions.

The Slovak Republic belongs to countries that are changing approach to taxpayers. In the measures of the Financial Administration of the Slovak Republic prevailed in the past rather restrictive measures primarily aimed at reducing tax evasion. The new strategy is largely focused on pro-client measures to promote voluntary tax compliance. In 2018, Slovakia introduced the institute of the tax reliability index. It will assess taxpayers in terms of a long-term tax discipline. Depending on the degree of tax reliability, taxpayers can benefit from the special tax regimes for reliable tax entities within the legal framework such as shorter deadlines for controls, exclusion from some tax controls and faster procedures for VAT reimbursements.

The results of the questionnaire survey mentioned in this paper support the hypothesis that tax morale plays a significant role in a decision-making of taxpayer. On this basis, tax authorities should take measures to encourage taxpayers to voluntarily fulfill their tax obligations and to reward taxpayers for acting responsibly and in compliance with the law.

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References


