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## The Economic Psychology of Tax Behaviour

Tax evasion is a complex phenomenon which is influenced not just by economic motives but by psychological factors as well. Economic-psychological research focuses on individual and social representations of taxation as well as decision-making. In this book, Erich Kirchler assembles research on tax compliance, with a focus on tax evasion, and integrates the findings into a model based on the interaction climate between tax authorities and taxpayers. The interaction climate is defined by citizens' trust in authorities and the power of authorities to control taxpayers effectively; depending on trust and power, either voluntary compliance, enforced compliance or no compliance are likely outcomes. Featuring chapters on the social representations of taxation, decision-making and self-employed income tax behaviour, this book will appeal to researchers in economic psychology, behavioural economics and public administration.

ERICH KIRCHLER is a Professor in the Faculty of Psychology at the University of Vienna. His research interests include economic psychology, household financial decision-making and tax behaviour, and he has written several books in these areas.

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Erich Kirchler

*University of Vienna, Austria*



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## Foreword

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*Valerie Braithwaite*

This book brings together research that has traditionally been fragmented into camps of legal, economic and social-psychological scholarship. Each camp acknowledges the need to be aware of the others' findings, but few books have been as inclusive and successful in creating a coherent framework that can house these different bodies of research. Kirchler describes the various research traditions in detail, setting out the building blocks for the reader to survey at close range. These parts are then assembled to provide an integrated account of how some taxpayers take the path down the slippery slope of non-compliance, while most stay on the high ground. Kirchler acknowledges that some individuals are less willing to say no to evasion than others, that some are less committed and able, and that varying social contexts can make it easier to comply or harder. But the spotlight is not only on the strengths and weaknesses of individual taxpayers and their immediate environment. Tax authorities play their part too and can adopt enforcement policies that are likely to push taxpayers down the slippery slope. Too often tax authorities fail to communicate respect and trust to the taxpayer, instead playing the 'cop' who is single-mindedly in pursuit of the 'robber' taxpayer.

This book provides a new frame for analysing tax compliance research. Classic economic theory depicting taxpayers as rational cost-benefit analysts has long provided the benchmark for evaluating new developments in tax research. In this book, Kirchler reinvents the frame. The classic economic view is no longer the standard but rather one of many possible social representations of taxpaying. Kirchler examines the role of individuals' perceptions of gains and loss, opportunities and obstacles as they appraise taxpaying demands. The lens is then broadened to incorporate sociological and psychological understandings of social context and cultural setting, and the part such factors play in determining how taxpayers approach and deal with tax authorities. Kirchler integrates the various theories and models of tax compliance as different kinds of social representations, and through a meticulous review of the literature presents a question that he both answers and poses for future tax

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compliance work: what are the circumstances in which these different models have most leverage for changing behaviour?

To read this book is to enter a treasure trove of research on taxation compliance. Consecutive chapters present accumulated knowledge in the different worlds of taxpayers as rational actors and trusting citizens, as self-employed business owners and taxpaying employees, as willing, reluctant or inaccurate payers and as calculating avoiders and evaders. The recurring theme is that the social representations of individuals matter and shape how taxpayers approach the demands made by tax authorities. Recognising disparities not only in types of taxpayers but also in intellectual traditions and analytic methods, Kirchler tracks the tax compliance story across taxpaying groups, academic disciplines and countries with divergent laws, norms and traditions. This book is a timely and invaluable contribution to a field that has for more than a decade been seeking a positive account of why people pay taxes.

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## Preface

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This book seeks to collect and integrate economic-psychological research on tax compliance in general, focusing specifically on tax evasion. Research findings are integrated into a model based on two dimensions: originating from the interaction climate between tax authorities and taxpayers, the dimensions are defined by citizens' trust in authorities and the power of authorities to control taxpayers effectively. Depending on trust and the use of power, either voluntary compliance, enforced compliance or no compliance are likely to result. While economic studies on tax evasion have been growing immensely in the past decades, only about 10% of publications assume an economic-psychological perspective, i.e., one that focuses mainly on individual and social aspects of tax representations, decisions and behaviour. Thus, this book aims to fill the present gap by reviewing the accumulated economic-psychological knowledge and mapping the field.

After a brief introduction, the increasing concerns with the complexity of tax law and the growth of the shadow economy are described, and definitions of tax compliance, avoidance and evasion are presented. As a psychologist, I choose to approach tax behaviour from an individual and social-psychological perspective. The available research focuses on individual and the collective (social) representations of taxation as well as on tax morale, and decision-making. I have chosen to afford the majority of attention to income tax, with special attention to self-employed taxpayers' behaviour. More recently, interest has been shown in tax authorities' orientations towards taxpayers and the interactions between tax officers and taxpayers. This book picks up and expands upon this important research trend.

After the introductory chapters, research findings on social representations are presented. Essentially, the chapter on social representations collects information on taxpayers' knowledge about taxation and subjective constructs, or lay theories of tax issues. Second, attitudes towards fiscal policy and taxation are reviewed. The chapter proceeds by focusing on norms, especially on personal norms (conceived as a belief that there is

a moral imperative with which one should deliberately comply); social norms (conceived as prevalence of tax evasion among a reference group); and societal norms. Next, behaviour control, defined as perceived opportunities not to comply, is described. Moreover, fairness considerations are of special importance: as shown, distributional, procedural and retributive justices are frequently found to have lasting effects on tax behaviour. After addressing subjective understandings, attitudes, norms and perceived opportunities, as well as fairness considerations, the focus is directed towards tax behaviour via discussions on motivational postures at the individual level and tax morale at the collective level.

Literature on income tax behaviour often rests upon the assumption that taxpayers deliberately decide whether or not to pay their share of taxes. While it can be argued that taxpayers may often spontaneously cooperate and comply rather than deliberating on their decisions, the economic approach almost exclusively addresses tax behaviour as a (rational) decision outcome. If taxpayers make decisions with the aim of maximising their individual profit, the dominating economic approach suggests that they face a risky decision. One must decide between paying taxes correctly or opting for the risky alternative, which is accompanied by a possibility of saving money, as well as the possibility of audit, detection and, in the case of evasion, fines. Depending on audit, as well as detection probability and fines, taxpayers choose the alternative that promises the most favourable outcome. The description of rational decision-making is followed by considerations of effects of repeated audits. Finally, it is argued that decision-makers often depart from rational decision-making by applying heuristics and falling victim to biases. Prospect theory, which addresses risk bias, has been successfully applied to tax behaviour.

The next chapter is dedicated to the tax behaviour of self-employed and entrepreneurial individuals. The obligation to collect various taxes for the tax office, paying taxes out of pocket and having various opportunities to cut income declarations or exaggerate expenditures makes the tax situation of the self-employed unique. Throughout the book, the focus is on individual income taxpayers. Therefore, payment of other taxes is rarely addressed, nor are corporations' tax engagement and corporate crime explicitly addressed.

The next section of the book deals with the interaction processes between tax authorities and taxpayers as a central theme. The approach tax authorities and tax officials take, their beliefs about taxpayers' behaviour and the respective interaction styles are of paramount importance in determining the tax climate. I argue that taxpayers react in

accordance with the approach taken by the tax authorities. A ‘cops and robbers’ approach is likely to breed distrust, corrupting voluntary cooperation. However, ‘trust is an important lubricant of the social system,’ wrote Kenneth Arrow (1974, p. 23). ‘It is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people’s word ... it [is] essential in the running of society.’ In a climate of distrust, authorities resort to control and punishing misbehaviour and must enforce citizens’ compliance. On the other hand, a ‘service and client’ approach, which is characterised by supportive and respectful treatment of taxpayers, transparency of procedures and acceptance of authorities, is likely to enhance trust and a cooperative atmosphere leading to voluntary compliance. Whereas a ‘cops and robbers’ or ‘command and control’ approach establishes a climate of distrust, a ‘service and client’ approach is assumed to reduce the ‘social distance’ (Bogardus, 1928; V. Braithwaite, 2003a) between taxpayers and tax authorities, thus creating a climate of mutual trust and voluntary cooperation.

The final section offers conclusions that are to be taken cautiously. Firstly, economic-psychological research is still in its infancy, providing merely isolated results rather than an integrative model of tax behaviour. Secondly, research on tax behaviour faces a bulk of methodological problems, vague conceptualisations of phenomena and heterogeneous operationalisation of assumed determinants of tax behaviour. Unsurprisingly, effects of determinants (or consequences) of tax behaviour were sometimes found to be strong, sometimes weak and sometimes insignificant or even in the opposite direction to expectations. Contradictory findings may be due either to methodological idiosyncrasies or to the neglect of relevant differentiating variables. Furthermore, tax behaviour has not been systematically studied in different political and tax systems, nor have cultural differences been satisfactorily explained. I argue that the tax climate predominantly results from the interaction style between authorities and taxpayers, which might be a crucial differentiating variable: in case of a ‘cops and robbers’ approach, a hostile, non-cooperative climate may result. In a system of hostility and non-acceptance of authorities, taxpayers may seek to maximise their individual profit, make (rational) decisions, and comply only if the authorities have the power to command and control taxpayers and to enforce compliance by effective audits and severe fines. On the other hand, a ‘service and client’ approach should create a basis for mutual trust and a cooperative tax climate, with taxpayers accepting the authorities and being spontaneously willing to contribute to the collective good.

I argue – and summarise in the ‘slippery slope model’<sup>1</sup> – that trust in the authorities and voluntary compliance integrate favourable social representations, that is, basic comprehension of tax laws, favourable tax mentality, favourable personal, social and societal norms and a perceived fairness with regard to distribution of tax burden, benefits and procedures. Trust depends on cooperation and favours cooperation. A cooperative climate is based on and favours compliance, which is derived from commitment as a motivational posture and from high tax morale in the society. Rather than guaranteeing compliance, audits and fines may have opposite effects in a trustful climate and thus corrupt voluntary compliance. Trust can spiral downwards to reduced levels when authorities respond to low levels of cooperation with control and punishment. Audits and fines may be highly effective in a completely distrustful climate with high social distance between authorities and taxpayers. In such a climate with no voluntary compliance, compliance can be enforced by the power of the authorities. However, audits and fines as the ‘tools’ to command and control taxpayers will not be suitable to create a cooperative tax atmosphere.

If interaction between tax authorities and taxpayers is a crucial variable, future research should consider tax climate as a variable that moderates the effects of both audits and fines and social representations. If the climate is characterised by distrust, but the state has the legitimate and expert power to control and fine non-compliant citizens, compliance can be enforced. However, if the climate is characterised by trust, authorities’ power is of less importance: citizens will comply voluntarily. If the tax authorities’ approach to taxpayers proves to be of crucial importance to establish mutual trust and voluntary compliance, the practical consequences are, among others, to aim for more simple tax laws comprehensible to ordinary taxpayers, better information detailing the distribution of tax burden and benefits, guaranteed procedural and retributive justice and efficient communication of social norms in order to promote taxpayer collaboration and enhance tax morale.

### Acknowledgements

I would like to express thanks to numerous friends, colleagues and institutions that have supported this work. In particular, I wish to thank the University of Vienna, Austria, for permitting a sabbatical leave enabling

<sup>1</sup> The term ‘slippery slope model’ was introduced by Henk Elffers at a conference in Leiden, The Netherlands, on ‘Managing and maintaining compliance’ (10–11 April 2006), where I had the opportunity to talk about ‘Why people comply’.



me to research, select and review hundreds of scientific articles for the writing of this book. The Australian National University at Canberra and the University of Sydney, Australia, deserve special gratitude for the invitation to spend six months with them and for all the necessary support for conducting this work. Enormous thanks go to Valerie and John Braithwaite and their research teams at the Research School of Social Sciences (Centre for Tax System Integrity, Regulatory Institutions Network), Australian National University for their collegiality and extraordinary generosity in providing material and scientific support, for invitations to join their workshops on tax compliance and regulatory justice and discussing research on tax compliance. I owe many thanks to Erik Hölzl and Stephan Mühlbacher, and many other research fellows at the University of Vienna, who cast a critical eye over the text and made many suggestions for improvements, and to Elisabeth Höllner, Eva-Maria Holy and Christine Talker for their attention to compiling the references, creating tables and drawing figures, and to Kate Connery for language correction and excellent assistance in editing the original manuscript of this book.

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