



Power, justice, and trust: A moderated mediation analysis of tax compliance among Ethiopian business owners



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ABSTRACT

We explored the moderating roles of legitimate and coercive power held by the tax authority in the relationship between procedural justice, trust in the tax authority, and voluntary tax compliance. Drawing from fairness heuristic theory and the slippery slope framework of tax compliance, we predicted that procedural justice fosters voluntary tax compliance, particularly when legitimate power of the tax authority is *low* and when coercive power of the authority is *high*. Moreover, we predicted that these interactive effects are mediated by (cognition-based) trust. Finally, we predicted that coercive power of the tax authority is positively related with enforced tax compliance. The results of a field study among Ethiopian business owners supported most predictions. This research is among the first to integrate social-psychological and deterrence-related factors to understand tax compliance behavior in a developing country.

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1. Introduction

Ideally, taxation is the most reliable source for financing government expenditure (Blöchliger & Petzold, 2009; Dziobek, Alves, El Rayess, Mangas, & Kufa, 2011). While other sources for financing government expenditure have various constraining conditions attached to them, the government is free to spend the proceeds from taxation in ways it deems necessary (Blöchliger & Petzold, 2009). A worrying fact in this respect is that while the government budget in many countries is overwhelmed by deficit financing, many citizens continually evade taxes (Alm, Kirchler, & Muehlbacher, 2012; Asaminew, 2010; Waud, 1986). Consequently, taxpayers' adherence to applicable taxation laws is something all governments throughout the world aim to secure (Bobek, Roberts, & Sweeney, 2007). Therefore, understanding what drives tax compliance is an important topic for scientific study.

Nevertheless, the literature on tax compliance of the past 50 years or so suffers from two important limitations. First, research has revealed that tax compliance is attributable to a range of factors that are economic or social-psychological

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in nature (Muehlbacher, Kirchler, & Schwarzenberger, 2011). Yet these various factors are usually studied separately. The economic model or deterrence approach to tax compliance (Allingham & Sandmo, 1972) assumes that the threat of sanctions (i.e., the probability of detection and subsequent penalties) shapes taxpayers' behavior. Many empirical studies support this claim (for a review, see Fischer, Wartick, & Mark, 1992), although some studies do not (Alm, Kirchler, & Muehlbacher, 2012; Andreoni, Erard, & Feinstein, 1998; Torgler, 2003a, 2003b). Social psychologists, on the other hand, attribute tax compliance to an array of noneconomic factors such as taxpayers' trust in authorities (Feld & Frey, 2002; Scholz & Lubell, 1998; Van Dijke & Verboon, 2010) and in other taxpayers (Alm, Kirchler, & Muehlbacher, 2012; Frey & Torgler, 2007), how taxpayers perceive the legitimacy of authorities (Kogler et al., 2013; Wahl, Kastlunger, & Kirchler, 2010; Wenzel & Jobling, 2006), the manner in which tax authorities treat taxpayers (Feld & Frey, 2002, 2007), and personal and social norms (Edling & Nguyen-Thanh, 2006; Lederman, 2003; Wenzel, 2004). Regretfully, there is at present little integration of deterrence-based and social-psychological perspectives, and hence we lack a clear understanding of factors that drive tax compliance (Kirchler, 2007; Kirchler, Hoelzl, & Wahl, 2008). One reason for this lack of integration may be that deterrence-based perspectives have usually focused on enforced tax compliance, whereas social psychological perspectives focused on voluntary compliance (Alm, Kirchler, & Muehlbacher, 2012; Alm, Kirchler, Muehlbacher, Gangl, et al., 2012).

A second limitation of the current tax compliance literature is that the vast majority of studies have been conducted in developed nations in Europe, Australia, and the United States (for reviews see Doyle, Gallery, Coyle, & Commissioners, 2009; Paliil, 2010). Tax compliance has been studied far less often in developing countries (for exceptions see Abdul-Razak & Adafula, 2013; Smulders & Naidoo, 2013), and no research in developing countries has integrated deterrence-based and social-psychological perspectives on tax compliance. Yet the tax environment in many developing countries differs in important ways from those in Europe and the US. In developing countries, taxpayers usually do not see paying taxes as a contribution toward building common public goods, but rather as a burden imposed on them by government (Asaminew, 2010). Moreover, tax authorities often show little trust in taxpayers and seem to believe that deterrent actions can solve all problems related to tax (non-)compliance. Therefore, taxation environments in developing countries often feature so-called "cops and robbers" relationships between taxpayers and the tax authority (Kirchler et al., 2008).

In this article, we will address the two above-mentioned limitations of the tax compliance literature. We will integrate the role of the most relevant deterrence factor – that is, the power of the tax authority – with a core social psychological antecedent of voluntary tax compliance, namely, the procedural justice of the authority. Drawing from the slippery slope framework of tax compliance (Kirchler, 2007; Kirchler et al., 2008), we distinguish between legitimate and coercive power on the part of the tax authority. Based on fairness heuristic theory (Lind, 2001), we argue that procedural justice influences voluntary tax compliance particularly when legitimate power of the tax authority is low (vs. high) and when coercive power is high (vs. low). To explicitly ground our argument in relevant theory, we will also argue that the interaction effects of procedural justice with both types of power wielded by the tax authority on voluntary tax compliance are mediated by trust in the tax authority. Fig. 1 visually represents our proposed model. We test our model among business owners in Ethiopia – a country that is characterized by the type of strained relationship between citizens and the tax authorities sketched above (Asaminew, 2010; Vadde & Gundarapu, 2012).

2. Theoretical background

2.1. Procedural justice and tax compliance

Procedural justice (i.e., the perceived fairness of decision-making processes and procedures) results from a variety of factors (Leventhal, 1980). Typically, procedures are perceived as fairer when they are applied consistently over time and across the individuals or groups affected (Van den Bos, Vermunt, & Wilke, 1996); when they are applied accurately and are not motivated by authorities' self-interest (De Cremer, 2004; Saad, 2011); and when they allow those affected to voice their opinions (Lamberton, De Neve, & Norton, 2014; Tyler, Rasinski, & Spodick, 1985; Van den Bos, 1999).

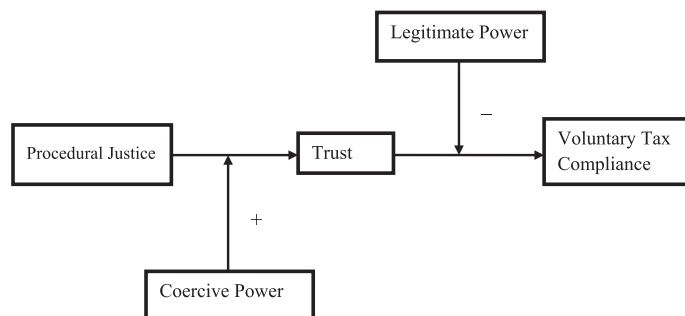


Fig. 1. A visual representation of how the legitimate and coercive power of the tax authority moderate the effect of low (vs. high) procedural justice on voluntary tax compliance.

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