



The effects of rewards on tax compliance decisions [☆]



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ABSTRACT

The findings of the tax literature suggest that the mechanism how tax revenues are redistributed has an important influence on tax compliance. One conjecture is that if the redistribution mechanism is perceived as positive by the taxpayers, this leads them to comply with the tax laws more truthfully. In contrast, for a negative perception, lower tax compliance is expected. To the best of our knowledge, there is no study systematically analyzing these effects. To fill this gap, we conduct a laboratory experiment and analyze how the redistribution of tax revenues influences tax compliance behavior by applying different reward mechanisms. In our experiment, subjects have to make two decisions. In the first stage, subjects decide on the contribution to a public good. In the second stage, subjects declare their income from the first stage for taxation. Our main results are three-fold: First, from an aggregated perspective, rewards have a negative overall effect on tax compliance. Second, we observe that rewards affect the decision of taxpayers asymmetrically. In particular, rewards have either no effect (for those who are rewarded) or a negative effect (for those who are not rewarded) on tax compliance. Thus, if a high compliance rate of taxpayers is preferred, rewards should not be used by the tax authority. Third, we find an inverse u-shaped relationship between public good contribution and tax compliance. In particular, up to a certain level, tax compliance increases with subjects' own contributions to the public good. Above this level, however, tax compliance decreases with the public good contribution.

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1. Introduction

Initiated by the paper of Allingham and Sandmo (1972), tax morale and tax evasion is discussed in many empirical and theoretical studies. The main objective of these studies is to analyze determinants of tax evasion to give politicians advice how tax evasion can be delaminated. For example, a higher audit probability of the tax authority or a higher penalty in case

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of a detected tax evasion leads individuals to declare their income more truthfully.¹ The influence of the tax rate on tax evasion behavior, however, is ambiguous as studies observe both a positive and a negative relationship.² In addition to these factors which have a direct influence on the monetary payoff of individuals, the literature has identified further determinants. For example, the level of tax evasion decreases if taxpayers participate in the decision process (see, for example, [Feld & Tyran, 2002](#); [Weck-Hannemann & Pommerehne, 1989](#)) or if the tax system is perceived as fair by the taxpayers (see, for example [Fortin et al., 2007](#); [Spicer & Becker, 1980](#)). Furthermore, individuals, who observe that other individuals declare their taxes truthfully, are more willing to comply with the tax laws (see [Feld & Tyran, 2002](#)). For detailed overviews on tax compliance determinants see [Torgler \(2002\)](#) and [Hofmann, Hoelzl, and Kirchler \(2008\)](#).

In our paper, we will contribute to this strand of literature by conducting a laboratory experiment to examine how the redistribution of tax revenue affects tax compliance behavior. If we look at the tax literature, we have many reasons to believe that this is an important topic for politicians and for the scientific area. More specifically, this literature suggests that the use of the tax revenue significantly influences tax compliance. [Alm, Jackson, and McKee \(1993\)](#), for example, found that the government program in which taxes are spent is crucial for tax payments. They argue that tax compliance can be increased if “taxes are spent in ways consistent with the preferences of the citizens” (p. 302). [Doerrenberg \(2015\)](#) show that tax compliance is higher when tax revenue is spent for research or charity purposes compared to when it is transferred to the country’s federal budget. [Li, Eckel, Grossman, and Brown \(2011\)](#) suggest that the low willingness to pay taxes is not due to a general aversion to give to the government, but rather due to a lack of control over the tax revenue use. They found that subjects reveal a higher preference for private charities than for government organizations and explain this result by a lower perceived effectiveness and efficiency in the latter case. In a study on shadow economy, [Torgler and Schneider \(2009\)](#) show that improving institutions (such as government effectiveness) leads individual to comply more honestly with the law. A literature overview and a discussion on the influence of personal benefits derived from public expenditure on tax compliance behavior are presented in [Torgler \(2002\)](#).

The literature on tax labeling and tax earmarking suggest that labeling a tax or providing information on how the tax revenue is used significantly influence tax perception and tax acceptance. [Hardisty, Johnson, and Weber \(2010\)](#) observe, for example, that the demand for airline tickets is higher when the surcharge for emitted carbon dioxide is labeled as a carbon offset than when it is labeled as a carbon tax. [Blaufus and Möhlmann \(2014\)](#) show that taxpayers are more averse to taxation with the label “tax” than with the label “transaction cost”. [Sussman and Olivola \(2011\)](#) observe in different surveys that individuals have a stronger preference to avoid tax-related costs than to avoid equivalent costs without any relation to taxes. [Kallbekken, Kroll, and Cherry \(2011\)](#) find that a Pigouvian tax to internalize negative external effects is more supported when it is labeled as a “fee” than as a “tax”. [Eckel, Grossman, and Johnston \(2005\)](#) observe in a laboratory experiment that the willingness to donate is lower if the decision problem is embedded in a tax context. [Hundsdoerfer, Sielaff, Blaufus, Kieseewetter, and Weimann \(2013\)](#) find that individuals perceive an additional income tax burden as less negatively if it is labeled as “health insurance premium” or “education allowance” than as an “income tax”. [Löfgren and Nordblom \(2009\)](#) reports that the tax label “gasoline tax” leads to stronger reluctance than the tax label “CO₂ tax on gasoline”. The authors argue that the reason for this label effect is that the label gasoline tax is associated with high prices on gasoline leading to a negative attitude. In contrast, a CO₂ tax on gasoline is associated with an environmental tax, leading people to be less reluctant to paying the tax. [Kallbekken and Aasen \(2010\)](#) and [Sælen and Kallbekken \(2011\)](#) argue that the deliberate explanation of the use of the tax revenue or an earmarking of taxes lead to higher tax acceptance and could increase the willingness to pay taxes.

In addition to these findings, the literature on tax evasion shows that the fairness of the tax regime – which can be seen as the perceived balance between taxes paid and public goods received and the perceived justice of procedures and consequences of norm breaking – has an important influence on tax compliance. In this context, [Hofmann et al. \(2008\)](#) distinguish between distributive, procedural, and retributive justice as types of fairness and report that an increase of one type of fairness leads to a higher willingness to comply with the tax laws in general. With respect to procedural justice – which concerns the process of tax collection and redistribution of taxes – it is shown that fairness perception increases if information on the tax laws is provided ([Wartick, 1994](#)), if taxpayers are informed about the social benefits of tax payments ([Holler, Hoelzl, Kirchler, Leder, & Mannetti, 2008](#)), if taxpayers are treated fairly ([Fortin et al., 2007](#); [Spicer & Becker, 1980](#); [Wenzel, 2006](#)), if taxpayers can participate in democratic decisions such as the decision how the tax revenue is used ([Feld & Tyran, 2002](#); [Torgler, 2005](#); [Weck-Hannemann & Pommerehne, 1989](#)), or if the tax authority is perceived as trustworthy ([Kirchler, Niemirowski, & Wearing, 2006](#)).

All these results indicate that the mechanism how tax revenues are redistributed has an important influence on tax compliance. One conjecture is that if the redistribution mechanism is perceived as positive by the taxpayers, this leads them to comply with the tax laws more truthfully. In contrast, for a negative perception, lower tax compliance is expected. To the best of our knowledge, there is no study systematically analyzing these effects. With our study, we will fill this gap. For this purpose, we conduct a laboratory experiment with a tax evasion setting. In each period, a subject has to make two decisions. In the first stage, a subject decides on her contribution to a public good. In the second stage, the income from the first stage is

¹ Studies with the focus on the influence of the audit probability on tax evasion are for example: [Spicer and Thomas \(1982\)](#), [Beck, Davis, and Jung \(1991\)](#), [Alm, Sanchez, and de Juan \(1995\)](#), [Maciejovsky, Kirchler, and Schwarzenberger \(2001\)](#), [Torgler \(2003\)](#), [Cummings, Martinez-Vazquez, McKee, and Torgler \(2005\)](#), [Fortin, Lacroix, and Villeval \(2007\)](#) and [Gërçhani and Schram \(2006\)](#). Papers analyzing the effect of the penalty are for example: [Alm et al. \(1995\)](#), [Maciejovsky et al. \(2001\)](#), [Feld and Tyran \(2002\)](#) and [Cummings et al. \(2005\)](#).

² A positive relationship between tax rate and tax evasion observe for example: [Friedland, Maital, and Rutenberg \(1978\)](#) and [Collins and Plumlee \(1991\)](#). In contrast, [Beck et al. \(1991\)](#) and [Alm et al. \(1995\)](#) observe a negative relationship.

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