

12 The economic psychology of value added tax compliance

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VAT: the background

Economic psychologists have shown a sustained interest in the psychology of taxation for 25 years. The progress made in the field is evident if one compares Lewis's (1982) *The Psychology of Taxation* to Kirchler's (2007) *The Economic Psychology of Tax Behaviour*. Whilst Lewis (1982) had to work hard to find enough material to describe and analyse, Kirchler (2007) had the opposite problem of having a vast amount of material to deal with. Much of this work has been on tax compliance and there has been a wide range of empirical research, from qualitative studies, through surveys to experiments, and the development of a large number of psychological theories and approaches to evasion and compliance (e.g., Braithwaite 2003; Elffers, 1991). But the focus of this research has been personal income tax: business tax compliance in general and Value Added Taxation (VAT) compliance in particular have been seriously neglected (see Webley, 2004). This focus does not derive from the financial significance of personal income tax evasion compared to business tax evasion. Instead, it seems more likely to be a consequence of the fact that psychology is well equipped, both methodologically and theoretically, to deal with the individual, and less able to cope with the explanation of behavior in institutions. That said, it is notable that work in economics on tax compliance (see Andreoni, Erard and Feinstein, 1998) has a similar bias towards investigating personal income tax, and again has many models that explain the behaviour of individuals, rather than institutions.

We will argue in this chapter that in order to understand VAT compliance one needs to move away from these individualistic approaches. In particular, occupational group membership and identity appear to be very relevant to taxpaying situations. We conducted a series of studies in both the UK and Australia using a mix of quantitative (surveys) and qualitative (interviews and focus groups) methods and techniques to determine and to demonstrate the

relevance of a social identity approach to tax evasion generally and to VAT evasion specifically.

Details matter: in the UK, a customer not paying VAT on a bill presented by a decorator is not breaking the law (the decorator is) – whereas in the Italy, the customer is deemed to be colluding with the decorator and so is also committing an offence. This particular detail significantly changes the nature of the act. As details matter, we will begin with a description of VAT and then move on to discuss what is involved in complying with this tax, before outlining some studies into VAT compliance and then considering how best to interpret the findings of these studies. Finally, we will present the findings from a series studies exploring the role of occupational taxpaying cultures in taxpaying behavior and attitudes, and consider the way in which they speak to issues in VAT research.

What is VAT?

VAT is a tax on consumer expenditure, collected on business transactions and assessed on the value added to goods and services. It applies, with some exceptions (for example to young children's clothes and shoes in the UK) to all goods and services that are bought and sold. VAT is a general tax (as it applies, in principle, to all commercial activities) and a consumption tax (as it is paid ultimately by the final consumer). It is not actually a tax on business though some business owners do see it that way. In fact whilst VAT is paid to the tax authorities by the seller of the goods or services, the tax is paid by the buyer to the seller as part of the tax and so, in essence, businesses are acting as unpaid tax collectors.

VAT was first introduced in France in 1954 and subsequently has been extended, through a series of directives, to cover the whole of the European Union (EU). The system in the EU is now reasonably standardised, although different rates of VAT apply in different EU member states. The minimum standard rate the EU is 15%, though lower rates are applied to certain services. Some goods and services are exempt from VAT throughout the EU (e.g., postal services, insurance, betting).

In addition to spreading throughout Europe (member states are required to introduce VAT, so the increase in membership of the EU has inevitably increased the number of countries that use this system), VAT has also been introduced in a large number of other countries, notably China (Yeh, 1997) and India, after many delays, in 2005, so that now over 130 countries world-wide operate VAT. In the Caribbean, for example, Belize, Dominica, Guyana, and Antigua have all introduced VAT in the last two years. Other countries have introduced taxes that are classified as Value-added taxes, such as Australia, which now operates a General Sales Tax (GST). The introduction of VAT has been the major tax reform around the world in the last 25 years and VAT is now of global significance and impact (Ebrill et al., 2001).

How VAT works

VAT is charged on most transactions whether these are sales to consumers or to other businesses. However, a business can credit the VAT it is charged on the items and materials it buys (“input VAT”) against the VAT it must charge on its sales (“output VAT”). An example should make the operation of VAT clear.

A builder who has carried out some construction work may charge the homeowner \$10,000. On top of that (assuming a standard VAT rate of 20%), the homeowner would pay \$2,000 VAT. So the total bill to the homeowner is \$12,000, of which the tax authorities will receive \$2,000. Let’s assume that the builder had to buy \$5,000 worth of bricks from Yellow Brick Road Supplies and \$1,000 worth of fittings from a company “Nice-space”. These will cost him \$6,000 and \$1,200 respectively. Yellow Brick Road Supplies will issue the builder a VAT invoice of \$1000, and Nice-space a VAT invoice of \$200. These invoices provide the evidence that is needed to claim an input tax credit. So when the builder submits his VAT return to the tax authorities, he will list the VAT he has charged (in this case \$2,000) and the VAT he is reclaiming (in this case \$1,200), and the difference between the two is the amount (\$800) he has to pay in tax (which is based on the value he has “added” to the raw materials).

Ultimately it is the homeowner who is paying all the VAT, but the money has been collected at different stages and three companies (the builder, Yellow Brick Road Supplies and Nice-space) have acted as tax collectors.

Not all transactions are charged at the standard rate. In the UK at the moment, for example, the standard rate which applies to most goods and services is 17.5 per cent. In addition there is a reduced rate of 5 per cent, which applies to, among other things, domestic fuel and power, and children's car seats, and a zero rate, which applies to food (but not meals in restaurants), books, and children's clothing. Some goods and services are exempt from VAT, such as insurance and education. Exemption and zero-rating are not the same. If a company sells zero-rated goods, since they are taxable, it can recover the VAT it has paid to its suppliers. Whereas an institution (such as a University) that is exempt, cannot register for VAT or reclaim the VAT it has paid.

It is quite possible for a VAT-registered company to be claiming back VAT from the tax authorities. This is quite common in the first year of a company's business because set-up costs may well exceed earnings. If a company continues to claim back VAT over a sustained period it is liable to get a tax inspection, as this situation suggests either that the company is not sustainable, or that there is some fraudulent activity.

The extent of VAT evasion

It used to be thought that VAT was less vulnerable to evasion than other forms of taxation, but there has been a growing concern this century about the size of this problem, especially in the EU. The European Commission (2004) for example, reported that revenue losses were as much as 10% of VAT receipts in some EU countries, though it is not at all clear what the basis for these figures is. There have only been a limited number of published studies, but from these it is evident that VAT evasion is widespread, though the extent varies greatly across countries. Agha and Haughton's (1996) review, based on studies from five countries in Europe and two in Asia, suggest that revenue losses vary from a low of 3% (France, United Kingdom) to a high of 40% (Italy). Bergman and Nevarez's (2006) figures from Latin America are within this range, with revenue losses being about 22% in Chile and roughly double this in Argentina. There are two points worth making about these figures. First, even the low figure represents a very large sum of money (equivalent to \$3 billion dollars for France). Second, relatively low revenue losses in percentage terms hide the fact

that a high proportion of businesses are probably involved in some non-compliance. So a study of Dutch businesses found that 34% of firms had evaded VAT (Cnossen, 1981) and Duverne (1990) reports that 66% of French VAT taxpayers audited had understated the value of taxable sales, and 40% had overstated the value of taxable inputs.

The most thorough analysis of the extent of VAT non-compliance is provided by Keen and Smith (2006). They summarise the official estimates provided in the UK by HM Revenue and Customs (HMRC) and the work on estimated VAT evasion rates in ten EU countries by Gebauer and Parsche (2003). HMRC have approached the problem of assessing the extent of VAT non-compliance in two ways. First, they have used a “top-down” approach, where national statistics on consumer spending are used, with appropriate adjustments, to estimate the amount of VAT revenue expected. This can then be compared with the actual revenue obtained to get a measure of the gap between expected and actual revenue. Second, they have used a “bottom up” approach, where operational data are used to guesstimate the amount of VAT evasion in various categories. These guesstimates are based on a variety of sources, including audits and the regular visits made to businesses by HMRC officers.

HMRC have been using the “top-down” approach since 1992 and over these 15 years the gap between expected and actual revenue has increased from just under 10% of expected revenue to about 15% — which equates to approximately 11 billion pounds. The “bottom-up” approach gives a broadly similar kind of figures, with the estimate of the tax gap being between 10–14.5% of expected tax revenue. This approach also allows estimates to be made on the sources of this loss. A large proportion (2.5–3.9% of expected revenue) comes from missing-trader or so-called “carousel” fraud, which exploits the fact that exports are zero-rated for VAT. Non-registration for VAT accounts for losses of 0.6–0.7% of expected revenue.

Gebauer and Parsche’s (2003) work, also using a top-down approach, gives rather different figures for the size of the tax gap in the UK (a three-year average of 3.8% for 1991–93), which presumably reflects different judgements about the nature and size of the adjustments that are necessary. This gives an indication of how difficult it is to make such estimates and how large the margin

of error must be. Gebauer and Parsche's (2003) work also shows, like that of Agha and Haughton, striking differences between countries. Italy is estimated to have the highest tax gap of the ten countries analysed at 34.5% — Greece's is lower, but still very substantial, at 20.2% and France's is estimated at 8.8%.

How to evade VAT

It is important to understand how businesses can evade VAT. A thorough account is provided by Keen and Smith (2006) — here we will discuss only the more common and simple methods. Perhaps the most obvious is not to register. Small businesses that operate below the threshold (currently £67,000 in the U.K, HM Revenue and Customs, 2008) do not pay VAT — this saves them tax and also the compliance costs. If turnover increases over the threshold there is a clear incentive not to register, and to maintain the competitive advantage that not being registered gives them over registered businesses. So-called “Ghosts”, small traders who are unknown to the tax authorities, may also be able to evade income taxes. A very common form of non-compliance is to under-report sales, particularly for those businesses providing personal services (decorators, hairdressers, builders working for private customers), as in this case the value added at the point of sale is very large. The customer may realise that the sale is being made without VAT and may share some of the gains from the fraud, as when a decorator offers a different quotation for a job depending on whether it is settled through a cash payment (“cash-in-hand”) or through an invoice and cheque or other traceable payment method. Another common method, when traders have goods that are liable to different rates, is to exaggerate the proportion of sales of goods in the lower tax rates. For example, cafes that sell food and drink to be consumed both on and off the premises might report more food being sold as takeaways (cold take away food and drink is zero-rated in the UK).

These forms of evasion are equally possible with a sales tax but there are some forms of fraud that are distinctive to VAT. The most important of these is probably the submissions of false claims for refunds. Bird (1993) puts this succinctly “a VAT invoice [is] a check written on the government.” These can either be completely bogus (forged invoices) or exaggerated purchases.

According to Bergman and Nevarez (2006) the use of fake invoices is the most popular way of evading VAT in Argentina, and a whole industry exists to provide these in areas such as “research and development endeavours” and “representation expenses.” Since exports are zero-rated fraudulent claims to have exported goods are a particular difficulty for VAT systems, and have led to much concern about carousel fraud in the EU. Carousel fraud involves transactions between companies in member states, where the goods go from one country to another and back (the “carousel”) and VAT goes missing.

Current approaches to VAT non-compliance

Studies of VAT non-compliance

There have been very few published studies of VAT non-compliance. We stress the term *published* as we know from conversations with officers from tax authorities in a number of countries that there are a number of internal reports on VAT compliance, which are kept confidential on operational grounds. We have been able to trace three different sources of studies: those carried out in Exeter, UK (Adams, 2002; Adams and Webley, 2001; Webley, Adams and Elffers, 2006), which use interview, survey and experimental techniques; experimental studies carried out in Trento, Italy (Mittone, 2001) and a study of the impact of audits using individual tax return information from Argentina and Chile (Bergman and Nevarez, 2006). We will consider each of these in turn.

The Exeter work on VAT compliance was part-funded by HMRC and there was a particular focus on small businesses and VAT. The research was not strongly theoretically driven: the aim was to test the relevance of psychological factors identified as playing an important causal role in income tax evasion to VAT evasion.

A number of different methodological approaches were used, but the most notable was the combination of survey data with compliance classifications provided by the HMRC. Two studies of this type were carried out (Adams, 2002; Webley, Adams and Elffers, 2006). For each, HMRC provided the names and addresses of catering and flooring/furnishing businesses owners with a turnover of less than £1m. These sectors were chosen to be contrasting groups: HMRC

believed the flooring/furnishing sector to be generally compliant, with non-compliance being more common in the catering business. The businesses were sorted by HMRC into four compliance groups: A = new businesses that had not been audited, B = visited in last 3 years by HMRC and found to be compliant, C = visited and found to be mildly non-compliant, D = visited and found to be seriously non-compliant. Questionnaires, colour-coded to indicate each compliance group, were sent to respondents. These differed in the two studies but both included a range of questions about attitudes, knowledge and behavior in respect of VAT. These included direct questions about compliance behavior (“how often over the past five years have you been involved in cash transactions so as to reduce VAT payments?”) and hypothetical questions about compliance (e.g., “If you had the opportunity to pay less VAT than you should do and you believed that there was absolutely no chance of getting caught, would you do so?”). The response rate was relatively low (13.5% in the first study, 18% in the second) though this is not unusual in survey research on tax issues (see Wallschutsky, 1996).

There were no significant differences in self-reported compliance between the two types of businesses in either study. However, in both studies there were differences in related variables. So those in the catering business were less likely to believe that people were honest, more likely to believe that under-declaring VAT would help profits, were less likely to think that the VAT system was fair and less likely to apply any decrease in VAT to their prices. This provides some support for the HMRC view of the differences between these two sectors.

More strikingly, there were only limited differences in psychological and other variables between the HMRC compliance categories, which can be summed up in two sentences. Group D (the serious non-compliers) had had significantly more penalties for late payment than the other groups. The non-compliers (Groups C and D) were younger, had been in business for less time and had a higher turnover.

However, there were a large number of differences between individuals classified according to their responses to a variety of questions (some mentioned above) as self-reported compliers or non-compliers. Compliers were older, were more community-minded than non-compliers and were more likely to believe

that VAT was a source of general taxation, that VAT evasion was wrong, and their reputation would suffer if they were discovered to have been non-compliant. Compliers were also more likely to believe that the paying of taxes was a moral responsibility of being a good citizen, that the VAT system was fair and more likely to feel guilty if they underpaid VAT.

The interview study reported by Adams and Webley (2001) fleshes out the picture painted by these survey studies. Twenty-seven people from three sectors (catering, flooring/furnishing and building) were interviewed. They were not asked directly about their own behavior in respect of VAT — compliance was raised indirectly, often by using a hypothetical question. Four interesting themes emerged from these interviews: fairness, sanctions, morality and “mental accounting.” Many people perceived inequities at some level: some felt that the VAT burden was particularly heavy on small businesses; some felt that it was unfair because of competition from unregistered businesses; and some (especially builders) resented having to do unpaid work for the government. There was a belief that HMRC had very strong powers and did not hesitate to use them, which contributed to a widespread belief that any evasion would be detected and punished. Morality was notable by its absence. There was a recognition that taxes are required to maintain our society but few people saw taxpaying as a moral issue. For them, minimising tax payments is good business practice that overshadows what might be considered to be good social practice. These themes (fairness, sanctions and morality) are all familiar from the psychological literature on income tax evasion. The final theme “mental accounting” is not. What this refers to is that the majority of respondents saw the VAT that they collect as their money and they begrudge paying it. A typical comment is “VAT takes about £12 thousand a year from my business so **I pay** just as much in VAT as what I earn” [our emphasis]. Contrast this with a much less typical comment: “It’s not a cost to the business, we’re just looking after the money for the government. There’s no point in worrying about paying. It’s their money.” The fact that so many participants felt a sense of ownership about VAT monies they collect clearly adds a new dimension to VAT compliance.

The experiments on VAT compliance carried out by Adams (2002) provide further support for the notion that inequity and mental accounting are

crucial in encouraging VAT evasion. Adams created a web-based restaurant simulation in which participants had to make a number of decisions – for example on the kinds of meals to be offered and their pricing, on advertising and on staffing – across a “two year” period. Pricing and other decisions were taken each month, VAT returns made each quarter and income tax returns made each year. Taxpaying was therefore just one decision among many that the participants had to make (unlike many tax compliance experiments where it is very evident that tax is the focus of the study).

Adams used two samples: one of restaurant owners, the other of catering and management students, in addition to participants recruited over the web. The results showed that those who evaded tax were more egoistic, saw VAT as unfair and tended to see VAT as coming from their business funds. This confirms the qualitative and survey findings, and suggests that the role of mental accounting in the compliance process for those taxes where businesses collect the tax on behalf of the government is an important one.

Mittone’s (2001) four experiments on VAT evasion are of a rather more traditional design. They are based on the classic competitive market experiment described by Bergstrom and Miller (1997). In this market, which is implemented on a computer network, there are several buyers and sellers, each of whom is given a reservation price. Each participant is allocated the role of either a buyer or a seller, which they keep throughout the experiment. Every period (round) of the experiment the sellers offer their good at a price of their choosing and the buyers can choose from the list of offers that appear on their computer screen. Thus far this is a very standard market experiment. What makes these experiments distinctive is that sellers and buyers can attempt to collude with a potential partner by clicking on a “collusion” button. The potential partner then has the choice of either accepting or refusing this offer of collusion. If he or she accepts both the buyer and seller benefit, but if they are caught by the tax authorities both are liable to pay a fine. If the offer of collusion is refused then VAT is paid on the transaction. In one of the experiments, sellers were able to expropriate the VAT collected from the buyers, and in this case only the sellers would be fined if they were caught evading.

Mittone's (2001) results are instructive. In the "expropriation" experiment, the main effect was to produce a generalised reduction in prices. Sellers appeared to use the ability to expropriate VAT so as to compete on price — which means that they were implicitly sharing with the buyers the advantage of expropriation, even though they alone run the risk of sanctions if they are caught. In the other three experiments, it appears as if sellers interpreted making a collusion proposal as a competitive mechanism, and buyers saw it as a way of saving money. What is interesting is that the task of proposing collusion became associated with a given role (buyer or seller) within each experiment but was different across experiments. In other words, there were emergent norms about who should offer collusion. Related to this, there are clear reputation effects, where buyers show loyalty to particular sellers — this of course makes particular sense where collusion in illegal activities is involved.

Bergman and Nevarez' (2006) study of the impact of audits on VAT compliance uses a very different kind of methodology. They used individual tax return data from two groups of Argentine and Chilean taxpayers. The experimental group had been audited — the control group consisted of taxpayers who matched individuals in the audited group for location, trade and level of tax payments. The dependant measure used was the debit/credit (D/C) ratio, where debits were the total VAT charged when goods or services were sold, and credits were the VAT already paid by the taxpayer. The lower the D/C ratio, the more likely it is that an individual is being non-compliant, though the type of industry and size of the company have to be taken into account in benchmarking these figures. So a service company with a D/C ratio of less than 1.5 would be considered as very likely to non-compliant, whereas this ratio for a food processing company would indicate a profitable and compliant company.

The results of the analysis show that in the period prior to the audit, the D/C ratio for audited taxpayers in both Chile and Argentina was lower than in the control group (e.g., it was 90% of the median figure for the control group). This is to be expected as those selected to be audited would have been chosen by the tax authorities on the basis that they were probable evaders. Compliance for the audited groups in both countries increased during the year of the audit (to 104% in Chile) and afterwards returned to previous levels or an even lower figure (to

89% in Chile). This increase in compliance is largely a result of a reduction in credits, probably the consequence of people using fewer fake invoices. A more detailed analysis reveals that whilst audits have no or even a deleterious impact on those who were found to be non-compliant, they do increase post-audit compliance for those who were audited and found to be compliant.

Individualistic interpretations of VAT non-compliance

The results reported in the previous section, despite using a wide-range of methods and both psychological and economic theories, are all interpreted by their authors using individualistic approaches. Webley *et al.* (2006) for example, use a combination of the Australian Tax Office model (Braithwaite, 2003) and Elffer's (1999) WBAD (Willing – Being Able – Daring) model to interpret their findings. This essentially categorises individuals into types of taxpayers (for instance, those who are unwilling to evade taxes) and identifies the appropriate approach for the tax authorities to use with this group of taxpayers (in this case to rely on self-regulation, education and communication). Individuals may fall into particular categories because of their personalities or approach to life (such as being community-minded) or because they are deterred by financial and reputational risk. Webley *et al.* (2006) suggest that individuals may move from one group to another (so those who are in the daring group may be moved down to the “being able” group through appropriate punishment and then deterrence), so this model is not entirely static. Social groups are notable by their absence however, and there are really only two players in this model — the individual and the tax authorities.

Though Mittone (2001) sees VAT evasion through very different spectacles (in his case the prism of the standard Allingham and Sandmo, 1972, model of tax evasion), explicitly recognises three parties in VAT transactions (the seller, the buyer and the government) and acknowledges the essentially social nature of taxpaying, he too takes a very individualistic approach. Tax evasion is analysed as a straightforward decision based on the expected values of the alternatives. So the social act of collusion is reduced to a judgement about the costs of benefits of offering (or accepting) collusive proposals.

Bergman and Nevez (2006) do not outline a particular theoretical approach, beyond commenting that standard game-theoretic approaches to tax evasion predict no effect of audits on compliance. But their approach is implicitly individualistic, with particular types of taxpayers being characterised (e.g., as “entrenched cheaters,” “small group of free-riders” and “honest taxpayers”). They do however conclude that social context and norms matter — though they do not model this at all. For us, this raises the question of whether it is possible to explain VAT compliance using a more avowedly social approach, something we will explore in the next section.

An alternative approach to explaining VAT non-compliance

Although some models (and as noted above, researchers) recognise the role that social factors such as social and personal norms play in taxpaying behavior (e.g., Hessing, Kinsey, Elffers, and Weigel, 1988; Myles and Naylor, 1996), they tend to be treated in a simplistic and reductionist way. Also, in relation to VAT, research studies often treat small business individuals as a single homogenous group. In so doing, the importance of certain group memberships and norms has been overlooked. Small business individuals (and individual taxpayers come to that) are members of many different groups and so may be exposed to a range of cultures (and subcultures) with varying, and sometimes conflicting norms, values and behaviors. In particular, research suggests that different occupational sectors have very different traditions and norms (i.e., cultures) when it comes to tax compliance (e.g., Sigala, Burgoyne and Webley, 1999).

Taxpaying is unusual in that it is something we only start *consciously* engaging in as adults (e.g., everyone pays tax when they purchase goods from shops but would not necessarily think about this as taxpaying). Research shows that the concept of tax is something few young people, even those aged fifteen years fully grasp (Furnham, 2005). This means that even though individuals are likely to have experience of dealing with other rules and regulations, many embark on their careers as tax novices and could become acculturated into their sector’s taxpaying culture. Carroll (1992) suggests that a taxpayer could be late completing a return, overstate deductions, report the wrong type of deductions (e.g., mix business and personal) or even refuse to pay tax because they are

following common practices in their occupational group. In line with this, Sigala et al.'s (1999) qualitative study revealed that "cash-in-hand" payments are very common amongst tradesmen in the UK construction industry. As one of their respondents, a plumber articulated, "Everybody in that sort of business that I'm in they talk about accepting cash. It's a sort of everyday thing. It is accepted in the plumbing industry" (p. 240). Also, in an Australian interview study focusing on builders, Shover, Job and Carroll (2003) report that weekend work is routinely paid in cash and then not declared as income.

On the theme of cash-in-hand payments, in an Australian qualitative study (with business individuals, the general public and tax officials), Noble (2000) found that cash jobs are generally seen as socially acceptable and encouraged from industry peers. Despite their contribution, these particular studies are limited by their small sample size, and unclear definitions of culture. Also, although they look at occupational group membership, the focus of research has not, on the whole, been on occupational group norms (or values) per se but on the norms and values of friends, people taxpayers know and fellow citizens (e.g., Wallschutzky, 1984). Some of this research suggests that perceptions (as well as knowledge) of social norms do influence people's taxpaying behaviors (e.g., Alm, McClelland and Schulze, 1999; Bosco and Mittone, 1997; Cullis and Lewis, 1997; de Juan, Lasheras and Mayo, 1994; Porcano, 1988; Sigala, 1999; Vogel, 1974; Webley, Robben and Morris, 1988) and attitudes (e.g., Torgler, 2005). Consequently social norms have been incorporated into models of tax compliance by economists who recognise the significance of social variables (Alm and Martinez-Vazquez, 2003).

When investigating norms and values of this kind it is worth bearing in mind that findings from past social norm research have not always been consistent. Whilst some studies show that if a person believes non-compliance is widespread he or she is more likely not to comply, others do not. For example, Wenzel's (2005a) experimental research both in the lab and the field, and a survey commissioned by the ATO (Artcraft Research, 1998 cited in Wenzel, 2005a) revealed that whilst Australian taxpayers think that fellow Australians engage in, and endorse tax non-compliance, they personally regard it as inappropriate. Wenzel (2005a) suggests that the process of pluralistic ignorance

(see Allport, 1924, O’Gorman, 1986, Prentice and Miller, 1996) — where group members privately reject a group norm but believe others accept it — might be responsible for this norm misinterpretation.

These inconsistent findings could be partly due to definitional and measurement issues. Researchers have used a diverse range of conceptualisations and definitions of social norms (Kirchler, 2007). Indeed reaching a singular definition of culture is problematic, since it is a word that has different meanings depending on who or which domain is using it (e.g., anthropology, sociology, psychology; Sackmann, 1989). Schein (1996) defines culture as “a set of shared, taken for granted implicit assumptions that a group holds and determines how it perceives, thinks about and reacts to its various environments” (p. 236). Deal and Kennedy (1982) describe culture as “a system of informal rules that spells out how people are to behave most of the time” (p. 15). For them norms (a set of attitudes and/or behaviors prescribed or proscribed by an individual’s group membership; Livingstone and Haslam, 2008; see also Sherif, 1936; Turner, 1991) and values (what is desirable, that is, the accepted principles or standards of a group, Morris, 1956) represent the key elements of culture, and this is the working definition that we use.

As well as definitional and measurement issues, the inconsistent findings could also be related to the fact that the role norms play in behavior and attitudes is complex. A social identity framework aims to “unpack” some of this complexity and offers a more nuanced analysis of taxpaying norms and values. It is only in the past few years that this approach has been explored as a potential framework for tax research (see Taylor, 2003; Wenzel, 2002, 2004, 2005a, 2005b, 2007). The use of a social identity approach sits well with Akerlof and Kranton’s (2000) advocacy for the importance of identity in economic models of behavior.

A social identity approach

Taxpayers are members of many different groups. A social identity approach suggests that whilst taxpayers may think of themselves as individual and unique in comparison with others, in certain contexts they may think of themselves as belonging to some social category (i.e., common ingroup, Turner, 1991). This is

in comparison to an outgroup; a category to which they do not belong. It should be recognised that self and other categories can exist at different levels of abstraction, with higher levels being more inclusive (Turner, Oakes, Haslam and McGarty, 1994). The level of category abstraction is a relative concept, and so for any one person, more than one level of social self-category will be available — it is argued that no one level is inherently more useful or appropriate than another and none is more fundamental to who a person is (Turner et al., 1994). For example, people may categorise themselves as individuals, as members of a country, as members of an organisation or as members of an occupational group.

Taylor (2003) suggests that if a person categorises himself or herself as a group member in a taxpaying situation (and this group membership is meaningful), then what is good for the group collectively is likely to motivate behavior. However, if this person categorises himself or herself as an individual, personal self-interest (rather than a sense of what is good for the group) may motivate behavior. Which self-categorisation is salient in a particular context depends on situational and perceived factors (Turner et al., 1994; Wenzel, 2004). Taylor (2003) suggests that it is when social identity is salient, where greater similarity to ingroup others and greater dissimilarity to outgroup others is perceived, that attitudes and behavior become more in line with ingroup norms (Turner, 1991).

One important question is which identities are taxpayers likely to spontaneously adopt in taxpaying situations? In a survey study, Wenzel (2005b) attempted to address this question by coding participants' responses to the question "Can you describe the sort of people who you think of as being in the same boat as you when it comes to tax?" The findings revealed that taxpayers perceived themselves in terms of a large range of social categories. However, the most frequent self-categories referred to participants' employment status, economic status and occupational group — and given that people pay tax on the money that they earn whilst working this is perhaps unsurprising.

Subscribing to a social identity line of thinking suggests that taxpayers should be more influenced by social norms when they identify with the group to whom the norms are ascribed. If identification is weak social norms should be less effective or even ineffective. This is what Wenzel (2004) found in his study

focusing on national (Australian) identity and the social norm of what “most others” think that they should do in relation to tax. When there was a norm to pay tax, those who identified strongly with fellow Australians displayed a greater level of self-reported compliance. However, for those who only identified weakly, this norm was ineffective and in some cases, counterproductive. Since in this study only a relatively small proportion of participants were weak identifiers, Wenzel (2004, 2005a) advises a regulatory strategy where tax authorities make reference to social norms and widely shared views about the importance of paying one’s taxes honestly.

Wenzel (2004; 2007) and Taylor (2003) also suggest that it is conducive to tax compliance if tax authorities are included within this national self-concept — that is, authorities are seen as acting on behalf of national citizens (i.e., as ingroup members) rather than in opposition to them (i.e., as outgroup members). Authorities are only likely to be thought of as ingroup members if they are perceived as both fair and legitimate. However, as mentioned above, findings show that taxpayers often perceive the tax system to be unfair and see themselves as having a difficult relationship with the tax office (e.g., Adams and Webley, 2001; Noble, 2000; Wenzel, 2002). Also, Wenzel (2005a) found that the more power tax authorities are perceived to have, the less legitimate they are seen to be. However, those who identified highly with fellow Australian citizens (and presumably saw the tax office as included in this national self-concept) considered a powerful tax office to be more legitimate, than those who identified less highly with fellow citizens (see Wenzel, 2005a).

However, although making reference to national group membership and widely shared norms about the importance of tax honesty might be conducive to tax compliance, tax authorities have a *limited ability* to determine which identity is salient in a given tax context. Occupational group membership and identity, however, appear to be very relevant to taxpaying situations (Carroll, 1992; Sigala et al., 1999; Wenzel, 2002, 2004, 2005b, 2007), and in the next section we consider the findings of our studies in these areas, how they speak to issues in VAT research, and their implications for tax authorities.

Examples of the social identity approach applied to empirical work

Ashby and Webley's (2008) in-depth interview study set out to build a detailed picture of one occupational group's taxpaying culture — the hairdressing and beauty sector (Ashby and Webley, in press). The findings of this study (with 19 self-employed hairdressers and beauticians from the UK) indicate that factors which could affect taxpaying behaviors and attitudes (such as a reliance on accountants/tax advisors, the notion of an acceptable level of cash-in-hand payments, and the use of different mental accounts for different types of income) are tied to occupational group membership, as they are socially constructed within occupational groups and are a key component of the group's taxpaying culture. For example, there is a norm amongst hairdressers and beauticians that occasional cash-in-hand payments are acceptable. This and similar norms appear to be sustained through talking to fellow colleagues and clients. In line with this idea, Haslam, Turner, Oakes, McGarty and Reynolds (1998) suggest that group-based interactions foster consensus within groups. This could mean that in using cash-in-hand payments hairdressers and beauticians are acting in accordance with their group's shared norm, rather than making an individual decision arising from a cost-benefit analysis.

Although some of the factors that emerged in this, and our other studies (in particular, mental accounting, fairness, sources of tax advice, and tax as a legal rather than a moral obligation) have already arisen in the small business literature (see Adams and Webley, 2001; Ahmed and Sakurai, 2001; McKerchar, 1995), they have often been couched in relatively individualistic terms. Next, by drawing on the findings from our studies, we will explore how previous findings in relation to (a) mental accounting (b) sources of tax advice, (c) fairness and taxpaying as a legal (rather than a moral) obligation, can be interpreted in a less individualistic way.

As well as the interview study described above (see Ashby and Webley, 2008), we will draw on the findings from a UK self-report survey (with 46 hairdressers) and two other qualitative studies: a UK focus group study with 20 taxi-driver and hairdresser participants, and an Australian in-depth interview study with 15 hairdressers (for more details of these studies see Ashby, 2007). It might be noted that there is a particular focus on hairdressers in these studies.

This approach — of focusing on one occupational sector — was favoured because it is a way of obtaining detailed well-characterised information. It is also especially suited to the study of occupational taxpaying cultures, which are complex and under-researched. The rationale behind selecting the hairdressing sector was twofold. First, hairdressers have opportunities to make cash-in-hand payments, and as such are targeted by tax authorities (e.g., ATO, 2004). Second, practically speaking, compared to other groups (such as builders) hairdressers are accessible (since in the UK and Australia each city or town centre has a number of salons) and relatively easy to recruit. Also, that the data comes from two different countries strengthens our overall arguments; in so much as it provides evidence of the same “processes” in both countries. However, although this allowed for continuity and an in-depth understanding of one sector, this narrow focus does mean that there is a case for further research to be conducted with a wider range of occupational groups.

(a) Mental accounting

In both the UK and Australia, not declaring two sources of extra income (money from out-of hours payments and tips) seems to be acceptable in the hairdressing sector. Part of the reason for this, appears to stem from how this money is conceptualized. That is to say, this extra money is placed in a different mental account to ordinary taxable income, earmarked as “mine to spend as I wish”. Participants felt a sense of ownership over this extra money, in a way that they did not with ordinary income — where they recognised that some of it belonged to the tax office. As Holly, an Australian hairdresser, said, “if you want to give me a 10-dollar tip, you just give it to me and I put it in my pocket”. Tips in particular tended to be seen as a gift. Will, a UK salon-owner, who participated in the focus group study, articulated this:

If you were to have said do we agree with the fact that we should have our tips taxed, then you would have a major uproar, we would all be ranting and raving, screaming at you because we have to declare our tips and they get taxed okay, the very word gratis is, is, it’s obviously in Latin and it’s a grateful, it’s a gratitude, it’s a thanks, it’s like a

present, so it's like saying to somebody I'm giving you ten pounds for your birthday, that is a present ok, somebody saying to me I'm giving you three pounds fifty for doing my hair as a present.

Although for the hairdressers, taxing tips was an emotive subject, overall the taxi drivers (at least in our focus group study, see Ashby, 2007) seemed to have a more pragmatic attitude towards tips being taxed and did not perceive such a sense of ownership of this money. Their conversations around tax and tipping primarily focused on the way in which they organised their finances. Tips were conceptualised as just another part of their income, with one taxi driver, Sharon, "bunging" her takings from taxi fares together with her tips, and declaring all of it to the tax office. Similarly, another taxi driver, Pat, asked her accountant to ensure that any income she declares includes her tips.

Our findings suggest that the way in which different types of money are conceptualised (or, in other words, the mental account they are placed in) depends, at least to some extent, on the occupational group an individual belongs to, and the norms of this group. In relation to VAT, Adams and Webley (2001) found that some of their participants conceptualised VAT money as "mine," whereas others conceptualised it as "theirs" (the tax office's). What the present findings indicate is that the way in which VAT money is conceptualised varies as a function of occupational group. So whilst builders for example might see this money as "mine," another group who organise and think about their money differently might see it as the tax offices. The challenge for tax authorities is to pinpoint groups that hold this "it is mine" conceptualisation. Through interacting with trainees, possibly by holding training workshops, they could try and change how this money is organized and thought of. This fits nicely with a UK tax official's statement that, "The trick is to stop thinking of it as 'your' money" (Revenue Auditor, n.d., cited by Chartered Institute of Taxation, n.d.).

(b) Sources of advice

Although the tax office might see financial book-keeping as an important part of being an occupational group member (as it affects how tax forms are filled in), for the most part, our hairdressing (and taxi-driver) participants did not appear to

see it (or dealing with taxes) as particularly tied to, or a large part of being a hairdresser (or a taxi driver) per se. Interestingly though, they did see other rules and relations (such as those relating to health and safety) as more occupation-specific. As Rhonda, an Australian hairdresser put it, “It’s [book-keeping and taxes] not hairdressing.” Tax laws are complex and the skills required to maintain books, and manage finances are not necessarily the skills that attract people to run small businesses or become self-employed. This means that many small business individuals seek tax or financial book-keeping advice.

Hairdressers (more than taxi drivers) cited fellow colleagues as a source of advice. In relation to VAT, Sue, a hairdresser in our UK interview study, discussed registering for it with her friends, who had advised her not go over the VAT threshold (see Ashby and Webley, 2008). This is noteworthy because, it is through discussions with colleagues that certain taxpaying values and norms are likely to be transmitted (Sigala, 1999). Although there is likely to be variation between individuals, certain occupational groups may openly discuss tax practices more than others.

Although friends were one source of advice, it was accountants that acted as the primary source of tax advice for the majority of participants in all of our studies. For some (although not all) hairdressers having an accountant appeared to be tied to their own and others’ perception of them as “not good with figures” or “not that bright.” As Grace, a salon-owner from our focus group study said, “unless you know how to fill out your own tax return, which I don’t think most hairdressers could, then they [hairdressers] bloody better have an accountant.” Tracy, who participated in our UK interview study, echoed this sentiment: “I think it’s always advisable to have an accountant, especially when you’re not sort of mathematically minded, as I’m not really (laughs)” (see Ashby and Webley, 2008). However, although nearly all of the taxi drivers (from the focus group study) also had an accountant, one of the main reasons for getting one was not because they could not do it, but because they felt that the tax office might question the way they filled in their tax returns.

Overall, our findings fit with previous ones that small business individuals struggle to complete tax forms, and often rely on an accountant. However, our studies do more than reproduce past findings. Specifically, they add depth to

previous research by suggesting that decisions — such as whether or not to get an accountant — can be tied to occupational group membership. That is to say, hairdressers for example may get an accountant because they do not equate their occupation with being good at book-keeping. The findings also suggest that dealing with taxes is not necessarily an important part of being an occupational group member. This, and the confusion surrounding taxes could be tied to the fact that hairdressers, like many other groups, do not learn about taxes or book-keeping during their training. In the UK, although the self-employed can attend free courses run by the tax office, these courses are not occupation-specific and people need to actively seek them out. This does not seem to be an ideal strategy. Instead, it might be beneficial for authorities to run tax workshops (focusing on VAT and income tax) in occupational colleges or universities, as well as encourage such institutions to include occupation-specific tax material in their syllabuses. In so doing they could help dispel some of uncertainty surrounding tax forms and book-keeping, as well as make tax a more relevant part of being an occupational group member. Doing so would seem to be particularly important in light of the findings (from our UK survey study) that when tax was relevant to occupational group membership, respondents were more likely to think that they should cooperate with tax authorities.

(c) Fairness and taxpaying as a legal (not moral) obligation

As Richard Lambert, Director-General of the Confederation of British Industries (“Quote of the day,” 2007) said, “It is important that the tax system is fair” (p. 1). Although, as mentioned, past research illustrates the importance of fairness, legitimacy and treatment by tax authorities, our findings suggest that at a national level, tax authorities (in the UK and Australia) are not included in the national self-concept. That is to say, authorities are not seen as acting on behalf of citizens but in opposition to them. Similarly, at an occupational level there was a sense of an “us” (occupational group members) and “them” (the tax office) relationship. As one hairdresser from the UK focus group study said, “The tax inspector will do anything, he will bend over and he will pull out his back teeth to find one [a mistake].” A number of our participants (in the UK and Australia) were unhappy with the taxpayer-tax office (or government) exchange. According to Paul (a

hairdresser in the focus group study) his clients “don’t think their tax comes back to them, they’re not paying tax to benefit themselves they’re paying tax to feed the government.” There was also the perception (amongst some) that smaller businesses were targeted whereas, “the big boys are getting away with blue murder”(Liz, Australian interview study).

These findings are consistent with previous studies, which indicate that taxpayers tend to have a difficult relationship with the tax office and perceive the tax system as unfair (e.g., Coleman and Freeman, 1994; Noble, 2000). The following tax joke, featured on the Chartered Institute of Taxation website (CIOT, n.d.), captures the nature of this difficult relationship, and, indicate how ingrained negative perceptions of the tax office and its inspectors are:

Question: How can you tell when a tax inspector is trying to trap you into a confession?

Answer: When his lips are moving.

It is worth noting that not all regulators are thought of in this negative way. In particular, for the most part, hairdressers in (Australia and the UK) tended to see the health and safety department (another regulator) as there to “help them out” rather than “catch them out.” As George, an Australian hairdresser, articulated, “I don’t think they [health and safety] come in just to give you headache no, I think they’re just part of the regulations, they’re nice, they will advise you.” It therefore appears that the tax office need to work to improve the public image of themselves and of taxpaying more generally. This is not an easy task, as they need to strike a balance between being perceived as fair and approachable, and being thought of as having a “big stick,” which they can use when necessary.

At present it appears that they may have the “big stick” at the expense of being fair and approachable. Indeed Ross, a salon owner (from our UK interview study), who said he had been “had” by her Majesty’s Customs and Excise (which since 2005 has been HMRC) in the past described them as “the police,” saying, “the VAT office could walk in here now and shut me” (see Ashby and Webley, 2008). Also as Will (a hairdresser from the UK focus group study) articulated, the perception of the tax office as powerful and having “threat value” is ingrained in British culture.

One first step in achieving this balance between fairness and power is to treat taxpayers in a fair and understanding manner (e.g., see V.Braithwaite, 2003; Tyler, 1990). Although this suggestion is by no means an original, what our findings indicate is that tax authorities would be better equipped to treat taxpayers in this way if they had a better understanding of different occupational cultures. This is because it would prevent them from unduly targeting groups that already have a compliant or cooperative occupational taxpaying culture, and which might react negatively to being threatened with coercive tactics.

The suggestion to manage different occupational groups in different ways (that are appropriate for them) might seem commonsensical. However, whilst in recent years, tax authorities in the UK, US, Australia, France and Sweden have begun to conceptualise and treat taxpayers less like “robbers” and more like clients (Kirchler, 2007), and the ATO has adopted a responsive approach to compliance (see V.Braithwaite 2003), there is still a tendency for authorities (especially in the UK) to manage occupational groups in a very similar manner.

However, beliefs that the tax office is “there to catch you out” appear to be quite ingrained, and although treating groups in ways that are appropriate for them is beneficial in the sense that taxpayers receive fairer treatment, it can only do so much. Another suggestion would be to have more positive “tax” stories in the media. So rather than just reporting on tax rises, tax office mistakes or tax evaders, the media could be encouraged to report on the way tax money is used to fund different public services (such as health care, the police), which benefit everyone. Although the issue of how tax money is spent is a contentious one, such stories might go some way to convincing taxpayers that all tax money is not wasted.

Stories about the way tax money is used could also help to promote taxpaying as a moral as well as a legal obligation. This is important because if taxpaying is seen as “morally right,” a feeling of shame might act as a stronger deterrent to tax evasion or avoidance (Grasmick and Bursick, 1990). In line with previous VAT research, the present findings suggest that many taxpayers (in the UK and Australia) actually see taxpaying primarily as a legal rather than a moral obligation. An example of this can be seen in an Australian hairdresser’s statement that, “culturally it’s [taxpaying] not a moral issue.” This is a very

current issue, with a global religious authority, Pope Benedict XVI, calling for tax evaders to be condemned as “socially unjust” (Owen, 2007).

Concluding remarks

Thus far, we have sought to make a case that the findings from research into VAT compliance can be interpreted in a less individualistic light. With our social identity framework and focus on occupational taxpaying cultures, we move away from rational and individualistic approaches. This chapter has concentrated on research with small businesses rather than medium or large ones. However, large and medium businesses in particular are organisations and need to be understood as such (Webley, 2004). Although researchers with a specific interest in business crime recognise this (e.g., Braithwaite, 1989; Clarke, 1990; Delaney, 1994), those working in this area have produced little in the way of theory (Webley, 2004). This means that applying a social identity framework to research with medium and large businesses could be fruitful — especially given that J. Braithwaite’s (1989, p. 141) comment that “much thinking about corporate crime .<th>.<th>. adopts an overly economically rational conception of the organisation; it excessively downplays the corporation’s role as a choosing collective agent with organisational policies and values about social responsibility,” is still true of much research today.

Although in this chapter we recognize that when taxpayers’ personal identities are salient, personal self-interest may be more likely to motivate behavior, we reject the traditional economic conception that *all* taxpayers are rational utility maximizers all the time. Instead, for future research, we suggest a broader conceptualization of taxpaying behavior and attitudes in which economic, and social and cultural variables are seen as linked in the sense that economic variables (such as personal norms or perceptions of deterrence and fairness) can be tied to occupational group membership and shaped by group norms.

However, more research is required to develop a full model that clarifies and elaborates the interplay between occupational identity, occupational taxpaying culture and more economic variables in taxpaying attitudes and behaviors. Nonetheless, our take home message is that attention to occupational

group membership and, in particular, to different group's taxpaying cultures can help improve our understanding of why people hold certain tax attitudes and why they do (or do not) pay VAT.

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