

The Influence of Tax Culture in Improving the Tax Compliance

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Abstract

After decade of sluggish growth in many countries caused by the economic crises, governments inclined towards expansive fiscal policy expressed through decrease in tax rates and increase in public spending. The serious expansion followed by broad and diversified fiscal measures in public spending come to an end. Most developing countries build a higher ratio of debt to GDP that influenced on fiscal policy. The focus now is on the revenue side or exactly on tax revenues. These revenues become necessary for governments, because they impact the poverty, invest in projects that impact on the development, provide public services and the most important they build the infrastructure for long term growth. Furthermore, most of the developing countries face serious problems described through small tax base, large informal economy, weak government institutions, untruthful and corruptive administration, low levels of GDP per capita, low level of domestic savings, low levels of domestic investments, and as usually follows high rates of tax evasions by elites. All these factors were the reasons why many countries in the past inclined towards external sources for funding the government expenditures. But now we have announcements by many countries towards changes in the tax regimes with intention to impact the domestic sources of funding. That kind of action from the left governments triggered serious displeasure especially in small developing countries, which until now were used to use flat tax rates. These shift in tax policy opened one intriguing question about tax compliance, which is inevitably correlated with the concept of tax culture. This concept is new, and its main goal is to comprehend people's behavior in fulfillment of their obligations towards the government.

Keywords

Tax culture, tax compliance, tax discipline, tax morale, tax revenues.

1. Introduction

Tax revenues in the developing countries are becoming one of the crucial segments in tax policy through which the government intends to collect more funds in the budget. In case when the economies throughout the world are sluggish, the own resources are essential to achieve sustainable development, reduce unemployment, poverty inequalities, offer quality public goods and services and invest in capital infrastructure for expedite growth.

Tax avoidance and tax evasion are most common problem of every tax administration. It is believed that the government could be able to overcome this issue by ensuring efficient tax regime and modern healthy tax culture. In this case the tax regime and tax culture must be compliant with each other. The latter emphasizes the taxpayer's behavior and the tax laws in the country. Therefore, both the behavior of the taxpayers and tax officials form the concept of tax culture.

One of the possibilities to improve the tax revenues is overall culture of tax compliance where the citizens see paying taxes as fundamental part of their communication with the government. That's why the countries around the world and tax administrations develop innovative taxpayer education programs which would improve the awareness of the current and future taxpayers.

These educational programs are not only for improving the revenue collection, but also targeting the significance of tax payments. The focus is on emphasizing the social value of the taxes and the connection with public expenditure. It elaborates how the people's money are spent and more crucial the effects of tax evasions on the country and their citizens.

It is necessary for the governments to enable essential tax literature to be implemented on secondary level and universities, which in return will improve the awareness of tax laws, methods of filing, downsides of the informal economy where the taxes are not paid and its significance for economic development. Also, celebrating annual tax days, exchange of tax experience through regional tax administrations is one plus more in promoting good government practices.

In order to impose successful taxpayer educational programs, it is necessary to have serious political inclusion, good partnership with domestic, regional, international entities, business and civil society which will ensure long term sustainability and serious change in countries culture. Some public figures may also have impact on taxpayer educational purposes.

2. Definitions of tax culture

According to Schumpeter, the initial understanding of the concept of tax culture was entirely connected to the creators of the tax system. The other side, taxpayers as crucial one, was not taken into consideration. He said: "tax culture is an expression of human spirituality and creativity" which relates to refined and educated tax systems. Here, the income tax is perceived as the "sweetest blossom of tax culture, the 'highest achievements' of the technique of taxation and tax equity. It is obvious that Schumpeter relates the term tax culture to progressiveness in tax systems and their modern design. Not less important are tax administration, tax economist, politicians, academics – in one word the whole national tax system. [1]

Other economist like Spittler said that: "taxation is influenced by economic, social, cultural, historical, geographical, psychological and further differences prevailing in the individual countries and their societies". He makes distinction between cultivated and non-cultivated tax system, a concept related to creditor and debtor countries in the fifties. [2]

Other interpretations of tax culture focus exclusively on taxpayers. Michael Camdessus, Managing Director of the IMF in a speech at Moscow Institute of International Affairs formulated the taxpaying culture as a medium-term goal for transformation of the Russian politics. It should be based on voluntary compliance with transparent tax laws. [3] Other authors state that the tax reform can be successfully implemented if there is emphasized relation between tax administration and taxpayers. [4]

Vito Tanzi, IMF economist, sees the tax culture particularly as tax consciousness on the side of tax payers. Taxpayers are less aware because of the different economic concept. In planned economies the authorities tried to avoid contact between taxpayers and direct taxes and backboned on the indirect taxes, as a less noticeable tax. The implementation of explicit tax systems replied with obvious aggression from taxpayers. The question why somebody needs to pay taxes explains the core of the tax culture concept. [5]

The ministry of taxes in Russian Federation, Georgi Boos, remarked that "[t]here isn't any country where people are happy to pay taxes, but they do pay taxes [...] because of their tax culture". The alarmingly low compliance rates in the Russian Federation suggest that a "tax culture" in that sense has not emerged yet in the RF: "We need to develop a tax culture which nobody wants to

recognize". [6] Also, German Gref, Minister of Trade in RF, stated in interview that he "understands that tax culture cannot be imposed or inculcated in period of one year. Taxpayers felt untrustworthy towards the government for their plans regarding 13% flat personal income tax rate. They were expecting a rise in the tax rate. The minister admitted that the plans involve application of progressive income tax in time frame of 20 years until they conclude the goal achievement. With this statement, Gref correlates tax culture with income tax as the 'classics' had done previously in the past. Of course, the compliance side is also significant for establishing modern tax culture. In order to do so the Russian Federation implemented a project for tax modernization with establishing a pilot office in the city of Volzhsky, and harsh regional advertising which could educate the general public for the importance of taxes. Consequently, tax culture began to be taught in schools. Thus, tax culture is comprehension when "the state can amass taxes only until the amount which the citizens are willing to give". Therefore, tax official's capability to foresee this willingness to comply better and better over time can be understood as an element of tax culture. The similar situation occurred also in Macedonia where after a decade of flat personal income tax rates, the new liberal government is preparing to make changes in the tax system with another swing towards progressive income rates. This time only 2 (10 and 18%). Until 2006, the state had already implemented progressive income tax rates, but the compliance from the tax payers was very poor. In the past 11 years the people were adapted to the low rate of income tax, which was proven as good revenue source for expansive fiscal policy. The government argument that the social principle is very important in their program, creates negative reaction in the public. This could create again a problem envisaged through low tax moral and significant tax evasion, which was severely reduced with the current tax system of direct taxes. I agree here that the tax culture is inevitable correlated with the political culture and all those measures for gradual explanation of the goals is necessary to achieve better compliance from the tax payers.

Birger Nerre considers tax culture as "a country-specific tax culture is the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country's culture, including the dependencies and ties caused by their ongoing interaction. In most emerging countries, the concept of tax culture is understood as combination of tax tradition and cultural values such as honesty, responsibility, justice. All these values may be described under the concept of 'tax mentality' which is concluded of two segments *tax moral* and *tax discipline*. Both describe the interactions between the taxpayers and tax administration. The first is perceived as willingness to pay taxes, as sort of obligation feeling towards the government upon benefit principle or obligation towards the society under ability to pay principle. The behavior patterns of the tax payer are recognized as *tax discipline* and usually follow some changes in tax policies. [7]

In figure 1 is presented the embeddedness of the actors of tax culture as a subset of national culture. The tax code is determined from the nation's culture and institutions throughout the history which are crucial in one economy for enforcing the tax rules. Players involved in this game are taxpayers, tax administration, political representatives, tax advisors and academics. The pointers represent interaction among the different group of players and between the players inside the same group. These communication links are relevant for establishing adequate social connections and to nurture and improve them in the future. The author left out the communication between the taxpayers and academic community, because of inadequate perception of taxpayers, which behavior is very unpredictable resulting in individual decisions different from the proposed ones from the experts. That reflects negative on the academic's postulates for a certain model of taxpayer's behavior.

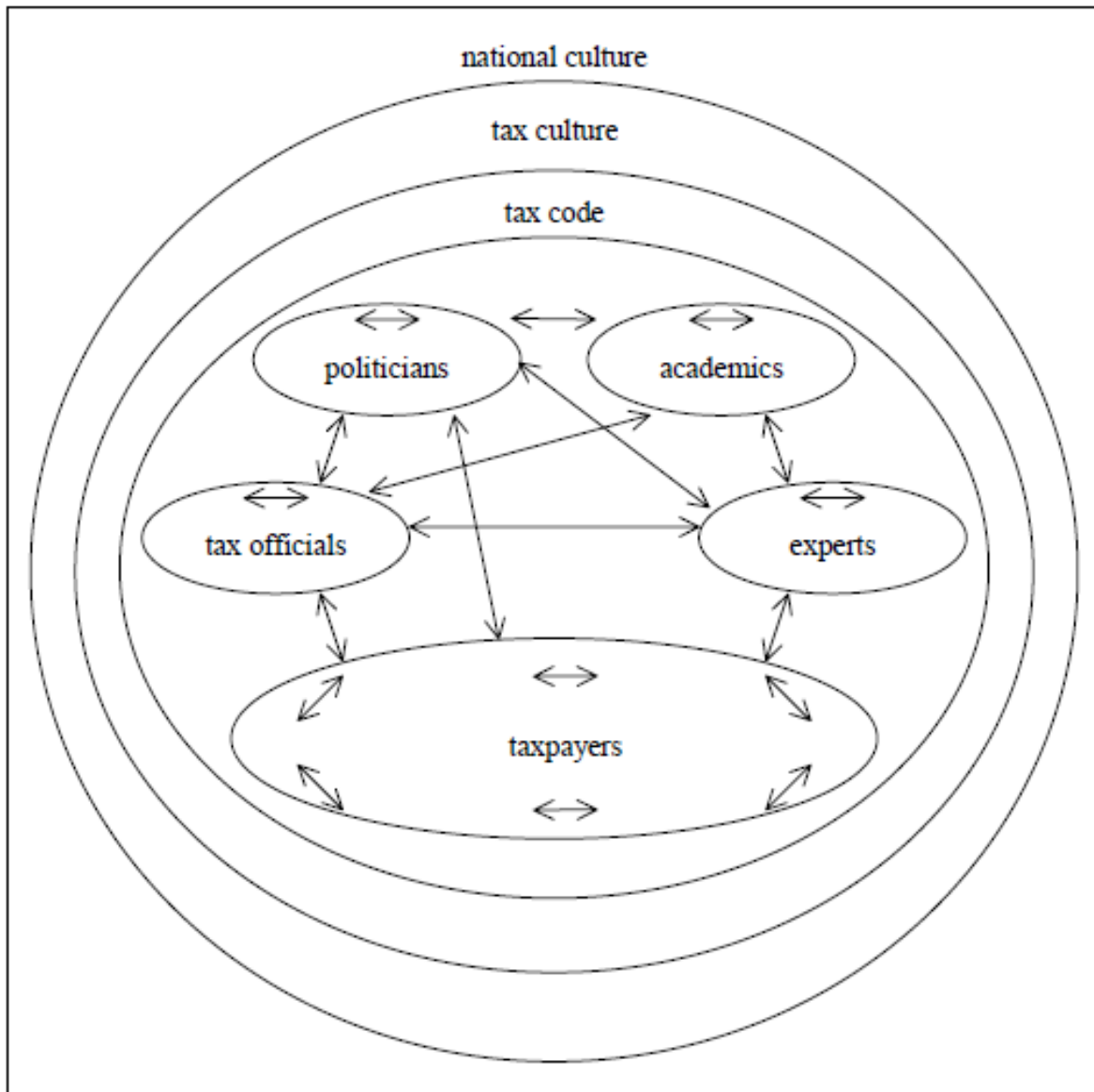


Figure 1 The Embeddedness of the Tax Culture

As a conclusion from all above stated opinions, tax culture is perceived not only from the aspect of the tax system and the current tax laws and practices, but also from the perspective of undergoing interactions between the tax administration and the taxpayers. The tax administration is obviously interested in: how will be determined the distribution of public revenues between central and local government? How concise are the tax laws? What is the remedy in case of their unfulfillment? Are there any interest groups that may favorize certain tax reform? All these dilemmas are essential component from the national tax culture, especially in transitional economies.

However, among a numerous economist prevails the opinion that the role of tax administration is more interlinked with the reliability and government integrity, which may promote some actions towards efficient tax compliance. Aside from the initiatives, strategies and instruments that tax administrations implement in order to increase control and reduce fraud and evasion, I think that some actions can improve the tax culture, perceived from the taxpayer perspective. Those actions are “*transparency*” and “*accountability*”.

The term “*accountability*” tends to prevent and correct misplacement of public power and to make tax institutions to be more open to public. That can be achieved through explanation and justification of their decisions. The trust and transparency of the public administration can be ‘game changing’ for the taxpayers from the perspective of effective evaluation of their performances. This

kind of fiscal transparency is also in process of implementation in Macedonia upon IMF demands which focus on public management and responsibility.

Transparency obviously is affected by new technologies, which are subject of implementation in tax administrations with intention also to influence on accountability. They all are equipped with websites containing detailed information about the institutions and their activities, structure, organizational charts, vision, goals, legal framework, taxpayer services, budgets and many other information's that are required by the public.

Global network that facilitates the dialog between governments, civil society, private sector (Global Initiative for Fiscal Transparency - GIFT) tends to find answers to the challenges regarding the fiscal transparency and participation of the citizens in the process of decision making. Especially relevant is the document "High level principles of participation, accountability and fiscal transparency", which intends to state out the relevance of access to reliable information, constructive participation, transparency and accountability in creating qualitative tax policies, promoting tax compliance, and increase the confidence in government.

Those ten principles are:

- 1) Everyone has the right to seek, receive and impart information on fiscal policies. To help guarantee this right, national legal systems should establish a clear presumption in favor of the public availability of fiscal information without discrimination. Exceptions should be limited in nature, clearly set out in the legal framework, and subject to challenge through low-cost, independent and timely review mechanisms;
- 2) Governments should publish clear and measurable objectives for aggregate fiscal policy, regularly report progress against them, and explain deviations from plans;
- 3) The public should be presented with high quality financial and non-financial information on past, present, and forecast fiscal activities, performance, fiscal risks, and public assets and liabilities. The presentation of fiscal information in budgets, fiscal reports, financial statements, and National Accounts should be an obligation of government, meet internationally-recognized standards, and should be consistent across the different types of reports or include an explanation and reconciliation of differences. Assurances are required of the integrity of fiscal data and information;
- 4) Governments should communicate the objectives they are pursuing and the outputs they are producing with the resources entrusted to them, and endeavor to assess and disclose the anticipated and actual social, economic and environmental outcomes;
- 5) All financial transactions of the public sector should have their basis in law. Laws, regulations and administrative procedures regulating public financial management should be available to the public, and their implementation should be subject to independent review;
- 6) The Government sector should be clearly defined and identified for the purposes of reporting, transparency, and accountability, and government financial relationships with the private sector should be disclosed, conducted in an open manner, and follow clear rules and procedures;
- 7) Roles and responsibilities for raising revenues, incurring liabilities, consuming resources, investing, and managing public resources should be clearly assigned in legislation between the three branches of government (the legislature, the executive and the judiciary), between national and each sub-national level of government, between the government sector and the rest of the public sector, and within the government sector itself;
- 8) The authority to raise taxes and incur expenditure on behalf of the public should be vested in the legislature. No government revenue should be raised or expenditure incurred or committed without the approval of the legislature through the budget or other legislation. The legislature should be provided with the authority, resources, and information required to effectively hold the executive to account for the use of public resources;
- 9) The Supreme Audit Institution should have statutory independence from the executive, and the mandate, access to information, and appropriate resources to audit and report publicly on the raising and commitment of public funds. It should operate in an independent, accountable and transparent manner;
- 10) Citizens should have the right and they, and all non-state actors, should have effective opportunities to participate directly in public debate and discussion over the design and implementation of fiscal policies. [8]

However, if the transparency is relevant for tax administration from the aspect of securing information about how much revenues are collected and the way they are collected, then it's also important for the public to be informed how much of that money are spent and on what. This principle makes public spending transparent along with all other initiatives that are undertaken by public administration like publication of revenues, targets etc., which at the end moderate the nation's tax culture. Conclusion is that tax administration has relevant and vital role in promoting good behavior practices regarding tax compliance, but not exclusive. In order to influence and promote tax culture, it is necessary to participate all public authorities, and not only tax administration.

It is obvious that although there are some joint rules in the tax policies, there are still some substantial differences between some tax regimes in European states that could relate to the tax culture. Some of the countries implement progressive tax structures that charge higher public revenue, opposite of others that create small amount of revenue and have flat tax rates. That could be related with economic, historical, social and political factors. They are difficult to be disentangled for empirical research. [9] It explores the cultural insights to explain why some countries have tendencies towards higher tax revenues and progressive tax structures than others.

While in the past was paid attention on the social aspects like equality in structuring the tax system, the aspects of trust and confidence were less explored. According to (Ariely, 2010, 259) numerous social and business endeavors are facilitated when there is high trust opposite of the situations where doubt and mistrust are high. High mistrust can influence on the realization of common goals like for example where other people act like free-riders and evade taxes that are inevitable to supply public goods by the state. [10]

However, if the political institutions in the country like government or parliament are highly tainted or mistrusted, and regarded as opportunistic bureaucrats, then the public would be more inclined towards public disobedience that could impact their functionality. Therefore, such societies with constant mistrust incline that economic activity is examined through individual and private sphere then collectively through public institutions.

This notion states that higher levels of trust are correlated with higher levels of tax revenues. The countries where in fact other people tax contributions are fairly spent and allocated, then it is expected from the public to accept higher levels of public expenditure. Conversely, countries with low levels of trust and confidence among societal members will have less faith in the integrity of their societal counterparts and public institutions and are thus more reluctant to accept high tax margins.

Cultural aspects if proved right could have serious implications on how the government should be applying modifications in their tax systems. Any suggestion for tax increase or opening in more progressive tax structure could prove as a disaster if it's not accompanied or preceded by transparent and public debate which would implant trust and assurance among society.

3. Tax morale

In the last 40 years, the basic model of tax evasion has been Allingham and Sandmo (1972), in which taxpayers decide how much of their income to report to the tax office by trading off the benefits of evasion (lower tax payments) against the cost of evasion (the possibility to be caught and punished). The crucial determinants that affect tax evasion are: tax rate, detection probability and the sentences invoked by tax administration in case of detected tax evasion. Tax officials are more worried about enforcement of tax laws and in improving "tax morale", which essence is voluntary tax compliance according to the countries laws and building a modern tax approach regarding paying taxes. [11]

The OECD, for example, noted that "[t]he promotion of voluntary compliance should be a primary concern of revenue authorities" in its principles for good tax administration and has highlighted the importance of tax morale more generally. [12]

Although the tax morale is viewed as individual thing, it is proper to state out that includes numerous motivational actions for tax compliance. It is important to figure out the channels through

which tax moral acts from the aspect of understanding the individual preferences and creating adequate policy answers. Tax moral could be examined through several channels which are not mutually exclusive from each other and are subject of interaction. The five mechanisms are: 1) intrinsic motivation, which can be viewed as an additional term in the utility function that increases in the amount of taxes that the individual decides to pay (with, possibly, a discontinuous upward jump for paying the required amount); 2) reciprocity, in which an additional utility term for paying taxes depends in some way on the individual's relationship to the state (for example, on public goods provided by the state or perceptions about the fairness of the tax system); 3) peer effects and social influences, in which the additional utility term for paying taxes depends on views or behaviors of other individuals; 4) long-run cultural factors may affect the willingness to pay taxes; and 5) information imperfections and deviations from utility maximization (for example, individuals may misperceive the probability of being detected in evading taxes or may exhibit loss aversion). About the importance of tax morale, World Values Survey made a research which showed important correlation among tax morale and tax compliance in developing and developed countries. Its concluded that tax morale is crucial determinant of the "shadow economy" and has influence on tax evasion. [13] Therefore, the complete comprehension of tax morale differences between the countries are essential in determining the differences in tax compliance also.

The World Values Survey provides data to help build a global picture of tax morale. The data from this survey was from around 90 countries. The question was "do you justify cheating on taxes if you have the chance?", a question to which 55 countries responded. The answers of the citizens' reveal socioeconomic and institutional factors that may influence tax morale in each of the regions. The socioeconomic factors were taking in to consideration marital status, religion, gender, educational attainment, employment status, economic status (self-reported), and economic problems (whether the household can save and/or get by or whether it needs to spend savings and/or borrow). [14]

On the other side, institutional factors are more about the government in general, which can elaborate how citizens perceive how taxes are being spent and thus affect their willingness to pay them. These factors include support for democracy, trust in government, and preferences for redistribution (i.e. whether taxing the rich and subsidising the poor is an essential characteristic of democracies).

From the survey it's obvious that these institutional and socioeconomic factors do have influence on the citizens tax moral:

- People with religious believes are more inclined towards paying taxes;
- Woman have shown that have higher awareness regarding the tax morale;
- Younger people are more creative in justifying tax evasion then old people;
- Educated people have more positive approach in aspect of paying taxes;
- Part-time workers and the self-employed have lower tax morale than full-time employees.

The results were in line with the perception that people with higher education and formal employment have a broader understanding of the role of taxation in the economy and society. Full-time employees are more likely to have income tax deducted by their employer.

This analysis has proven as useful in creating models of tax payers towards enhancing the mobilization of revenues. The results from the institutional determinants conclude that the government support from the public, the institutions and transparency had been beneficial in accomplishing larger tax compliance:

- The people with support for democratic society incline to be against tax cheating and consider it as inexcusable.
- The trust in government by the people is considered as vital factor in achieving high tax morale.
- Individual who understand and support fiscal redistribution as a fundamental concept of modern democracy, i.e. the policy to tax the rich with higher rates and fund the poor is such kind of elevation in tax morale.
- Also, there is enhanced link between people with high tax morale and those who show displeasure after claiming benefits they don't deserve. This link emphasizes the doubtful relation between tax paying and the peoples presumptions of tax usage.

With this study we have seen that tax moral is dependable from a wide range of factors which have various income levels. The areas such as civil society, business enterprises, international community can have substantial input in government policies for enhancing the tax morale and tax compliance:

- One of them is transparent and clear correction among revenues and expenditures. It is shown that positive ratings of the government, public institutions etc. may influence in increase in tax compliance and tax revenues. One way to enhance that link is through specific usage of tax revenues for specific public expenditures.
- Construction of countries own taxpayer profiles will help in providing essential information on how certain groups of people react on paying taxes and which ones understand the benefits of taxation.
- Better taxation of the informal sector as a serious problem in developing countries. To build a suitable tax culture, it is needed to have open dialog with small enterprises and stating the benefits of the tax policy.
- Transparent tax policy and modern tax administration can improve taxpayer experience. Their perception of tax officials, procedures, simplifying tax regimes and increased usage of information technology can improve tax morale and compliance.
- Efforts in many areas must be aligned to avoid negative interactions between drivers of tax compliance, because they can interact on each other. For illustration, taxpayer's perception that revenue office is overly controlling can cause mistrust in that institution. That would decline the mobilization of tax funds.

4. Conclusion

The primary goal of this paper was to enlighten a different aspect of tax policy which showed to be relevant from the aspect of tax administration. In times when many governments tend to increase their public revenues, first determinant that come in light is tax compliance. Why people act as they act in process of paying their taxes? What drives them to pay more taxes? What they think it's needed to create better interaction with the government? All these questions intend to address one serious problem in small developing economies – tax evasion and informal economy. In the process of unrevealing this dilemma one concept came as interesting and that's tax culture. Tax culture is dependable upon many social, economic, historical, normative factors which differ from one country to another. So, this paper tries to detect what are the essential elements that could create better interaction among taxpayers and tax administration in obtaining higher tax compliance, and of course building higher benchmarks for tax morale. It is concluded that in order to improve the tax culture it is inevitable to create more transparent and accountable public institutions that could be more public oriented. That means the citizens of the country must be informed on how their money are spent and what are they getting for that civil obedience. When they are aware of money trails and the benefits they get, then their approach towards tax administration will change. Many of the countries intend to improve this problem by stating out the penalties in case of noncompliance. But the more modern approach tends to implement tax information's in the educational system from small age, and in that way to create higher awareness between the people of the tax benefits. Also, there are a lot of seminars, publications, public appearances by tax officials, the use of new technology in collecting taxes, e-tax, mobile tax vans, etc.

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