

**FACTORS OF SUSTAINABLE TAX COMPLIANCE: A CONCEPTUAL APPROACH**

By

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The objective of this paper is to identify the factors of sustainable tax compliance explored on studies from diverse locations and applying them to the different conditions suitable for factors that influence the behaviours of sustainable tax compliance. Sustainable tax compliance is of key importance to the continued existence of various countries/economies. Many empirical studies in the research of tax compliance have been examined in order to lay emphasis on the impact of a wide variety of potential factors of voluntary compliance, individual income/profit tax filing, and reporting obligations. The most important factors noted are economic and non-economic in nature. Economic factors include the level of income, audit probabilities, tax audit, tax rate, tax benefits, penalties, and fines; where as non economic factors include attitudes toward taxes, personal, social and national norms, perceived fairness, and peer influence. The factors that guarantee optimal results of compliance vary with individuals, locations and other necessitating factors; this therefore provides room for thorough and continuous application of study findings in this area of research in achieving sustainable tax compliance peculiar for different locations.

Keywords: revenue, sustainability, tax compliance, taxpayer

1. Introduction

The collection of tax revenue is a task that has continued to be of immense interest to regulatory authorities, governments, and countries. Collection of tax revenue has continuously been an area of research for possible improvements in series of past studies and findings for better revenue collections. Sustainable tax compliance is the continuity in payment of tax liability timely and accurately to the authorities. It remains a prerequisite to the continuous existence and survival of global economies and governments in the world. The behaviour of taxpayers in regards to tax compliance has been found to be determined by many factors, which eventually inspires what taxpayer do.

The convenience and ease at which citizens or taxpayers pay their taxes and authorities collect or realize tax revenue assist in achieving sustainability of economies and governments and which further strengthens relationship in the area of governance. The issue of tax compliance has been approached from various viewpoints that shed light on different aspects of taxpayers' behaviour. Attitudes were measured, prevailing social norms and theories explored, which people have in mind when filling their annual tax declarations (Kirchler, 2007).

Compliance is greater when the individuals perceive some benefits from a public good funded by the tax payments while changes in fine rates appear to have little effect on tax compliance behaviour (Alm et al., 1992). Therefore, it appears that there are additional tax policy instruments beyond the standard prescription of enforcement actions that government can enact to achieve its desired degree of compliance with the tax laws. In fact, some of these standard instruments and greater penalties may be largely ineffective in increasing tax compliance. Also, government should pursue a range of approaches in its efforts to promote compliance (Alm et al., 1992).



The payment of fines and penalties appear for overdue taxes, there arises the need to allow audit by tax collectors if deemed necessary, especially if they suspect that there is some kind tax non compliance. The factors that influence tax compliance behaviours as propounded by different researchers and theories do not apply in same directions and give same results when considered in different countries. The Nigerian government is currently intensifying efforts to increase tax revenue due to the below budget oil revenue caused by oil theft and dwindling global crude oil prices.

The objective of this paper is to explore the many factors found out by different researchers from different locations and considering the different attributes influencing the behaviours of tax payers in line with tax compliance. This is to provide detail guide towards the combination of these identified factors to achieve desired tax compliance behaviours. The findings and position of this paper would be of importance to policy makers, revenue authorities, tax consultants, and academic circle pursuing and understanding the goal of improving tax revenue through unceasing tax compliance.

2. Literature Review

Conceptual Framework

Economic Factors

Level of Actual Income.
Tax Rate.
Fines
Audit Probabilities
Tax Audit.
Penalty

Non-economic Factors

Attitude
Norms
Fairness
Tax Information.

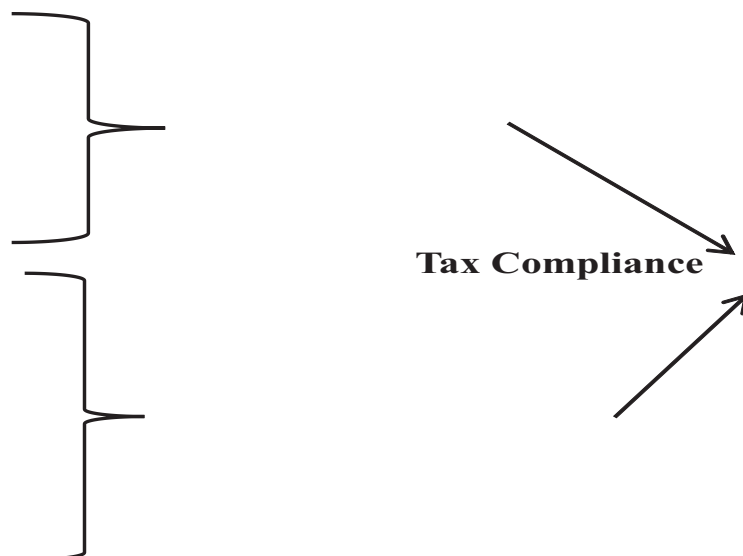


Figure 1. Economic and Non economic Factors for Tax Compliance

Conceptual Review

Economic Factors of Tax Compliance

In the area of tax compliance research, a number of economic factors have been considered to have some direct financial implications in explaining tax compliance and they include the level of actual income, tax rate, tax audit, audit probabilities, fines and penalties.

Level of Actual Income

The study of Spicer and Lundstedt (1976) pointed out that self employed have more possibilities to avoid taxes than employed taxpayers. That is, self employed taxpayers have more opportunities for tax evasion and these opportunities might further increase with the number of different income sources. Hence, in tax compliance decisions the level of income might intermingle with its source. Kirchler et al.



(2007) posited that participants were less compliant when they reported income earned by low effort than when they reported hard earned income. That is, the taxpayers are reluctant to lose their hard earned money by “gambling” with tax authorities.

Tax Rate

Economic models of rational compliance decisions provide either mixed predictions of the effect of marginal tax rate on compliance, or predict that increased tax rates would increase compliance (Allingham & Sandmo, 1972). However, the study of Pommerehne and Weck Hannemann (1996) opined that evasion increases with increasing marginal tax rates. More often than not, marginal tax rate could have a significant effect on under-reporting by tax payers. This is corroborated in the study of Clotfelter (1983) and Slemrod (1985) who found that the marginal tax rate has a significant effect on under-reporting. Nevertheless, the study of Alm, Jackson and McKee (1992) are of the opinion that tax rate increases could lead to higher tax evasion. Though, Kirchler et al. (2008) concluded in their study that tax rate had no effect on evasion and under-reporting.

Trust in a tax society plays a major role on tax collection and compliance. A low level of trust from tax payers that is accompanied by a high tax rate could be seen as an unfair treatment of taxpayers and an attempt to extort from them. Also, a high level of trust would be interpreted as contribution to the community. Regarding the source of income, Boylan and Sprinkle (2001) report that participants in their experiment reacted to a tax rate increase with lower compliance if they were endowed with income by the experimenters, but reacted with higher compliance to a tax rate increase if they had to earn their income by performing in a one hour multiplication exercise. Moser et al. (1995) in their findings seem to suggest that perceived fairness of the tax rate is more important than its absolute level. Judging the fairness of taxation, however, requires comprehensive knowledge and correct interpretation of the tax law, and complex tax rate structures, such as progressive taxation, that are not perfectly understood by taxpayers.

Tax Audit

Tax audit is one of the most effective policies to protect the behaviour of tax evasion. The level of tax audit can be determined by two elements which include how many taxpayers are selected for audit and how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second element is so difficult to measure due to no published information about the process of tax audit. It is commonly measured by the first element to indicate the level of tax audit for practical comparison (Hyun, 2005). Tax audit generates administrative cost. As a constraint of the fixed administration cost, an increase in the level of tax audit is required to decrease the level of other administrative functions, like taxpayer service, tax collection etc.

Audit Probabilities

Studies on the impact of audit probabilities on tax compliance have showed weak effects. Fischer, Wartick, and Mark (1992) review summarizes inconsistent findings on audit probabilities and tax compliance. For example, threatening taxpayers in an experiment (Slemrod, Blumenthal and Christian, 2001) with “close examination” of their upcoming returns increased tax compliance just for low and middle income taxpayers, but decreased it for high income taxpayers. Furthermore, laboratory experiments varying audit probabilities found low negative effects of audit rates on evasion, especially



for precise percentage information on audit probabilities instead of indicating high middle, and low probabilities (Spicer&Thomas, 1982). In contrast, other experiments report that imprecise information increases tax compliance (Friedland, 1982). Thus, it would be argued that objective audit probability is not important, but the subjectively perceived probability and its interpretation.

A review on tax compliance and audit probabilities by Andreoni, Erard and Feinstein (1998) showed that objective audit probabilities have little effect on compliance and concluded that subjectively perceived audit probabilities. Prior audits, from direct experience have a weak impact on tax compliance. An explanation is that prior audits may not turn out as badly as taxpayers initially feared (Andreoni et al., 1998). An individual's risk aversion, in this context, would be of relevance primarily under conditions of low trust; with high trust in the authorities; it would become irrelevant because the tendency to calculate probabilities and payoffs is replaced by following the fiscal norms (Kirchler et al., 2008).

The economic model assumes that taxpayers try to maximize the outcome of the compliance decision by weighing the gain of successful evasion against the risk of detection and punishment. The expected value of non compliance depends on audit probabilities and fines. Allingham and Sandmo (1972) therefore conclude that an increase in the probability of detection will always lead to a larger income that will be declared by taxpayers. They assumed that the notification letter induced high income that determined taxpayers to seek help of professional tax advisors to minimize their tax liability. The effectiveness of frequent audits was affirmed in the study of Kirchler et al., 2007. Subjective rather than objective probabilities should therefore be of greater interest in tax research.

Fines

Empirical studies on the impact of fines on tax compliance did not find the clear picture theoretical analyses provide. In sum, the relation of fines and tax compliance also shows inconsistent findings (Fischer et al., 1992). Some experiments showed that fines are slightly higher related to tax compliance than audit probabilities are (Park and Hyun, 2003). Keeping constant the expected value of a tax but changing audit probabilities and fines for non compliance, it showed that compliance increased significantly with higher fines, but not with higher audit probabilities (Friedland, Maital & Rutenberg, 1978). Other experiments, on the contrary, showed that fines and tax compliance are not related, but audit probabilities and tax compliance are (Friedland, 1982; Webley, Robben, Elffers, and Helsing, 1991).

It would be argued that the interpretation of fines matters. In an antagonistic climate, fines can be a part of the game of "Cops and robbers"; in a synergistic climate, they can be perceived as an adequate retribution for behavior that harms the community. Fines are therefore connected to trust and power. Fines that are too low could be perceived as indicator that the authorities are weak and unable to control the wrongdoers, undermining trust among honest taxpayers. Fines that are inappropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evaders to try even harder to regain their 'losses' incurred by those fines (Kirchler et al., 2008).

The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand, fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on taxpayers. On the other hand, if fines



are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid their taxes. In most countries, fines are relative to the evaded tax.

Penalty

The structure of penalty system may be different in the countries: can be various types of penalty rate by the different tax subjects or different structure of penalty rates by the types of taxpayers. So, penalty rates have been separately applied by the different tax subjects like the individual income tax, capital income tax, value added tax etc. Furthermore, the penalty rates for each tax subject are differentiated by the different types of evasion, like non filing, timely filing but under reporting, no bookkeeping of invoices, and receipts. The penalty rates are differently applied to the types of taxpayers, depending upon their evaded behaviours.

If some taxpayers had the intentional evasions, the penalty rate is much higher than that of unintentional evasions (Hyun, 2005). As two kinds of evaded behaviour are most common in analyze of tax compliance and are timely filing but under reporting, and non filing. If the countries have the same system that tax authority prosecutes some intentional and malicious tax evaders for criminal responsibility, after tax audit. This system might play an important role in increasing the level of penalty rates for the behaviour of tax evasion. The number of prosecuted cases by tax authority might be an important indicator to compare an additional penalty rate between countries.

Non-economic Factors of Compliance

Non-economic factors play a significant role on the level of tax compliance as well as tax sustainability. These non economic factors include the willingness to pay for public provision, public education, tax morale, tax information, peer influence, fear of God, cultural norms, and religious belief. As there are some limitations to include all non economic factors for the analysis of behaviour of tax compliance, most studies pay attention on just one or several factors for rigorous analysis.

Tax Information

The release of tax information might be one important determinant for tax compliance, as it gives taxpayers an exact figure about tax evasion. Most of developed countries release much tax information for taxpayers' right to know, but not for inducing more tax compliance of taxpayers. Tax information disclosure consist of two components which include tax statistics, and tax return for each taxpayer. Tax statistics assist in establishing the exact amounts of tax evasion (Hyun, 2005). The other information is given by the tax return information for each taxpayer. Countries such as Finland and Norway release tax return information for each taxpayer to the public.

In most developed economies, the tax return information for each taxpayer is strictly prohibited for release to the public for the protection of private information. The statistics about tax evasion has been released to the public for most developed countries. This information disclosure might be not only for taxpayers' rights to know, but also for inducing more tax compliance. Furthermore, some private information for the richest group of individuals and corporations has been released to the public under the legal basis. There are three tax subjects under this public notification system, which are individual income tax, corporate income tax and inheritance tax (Hyun, 2005)



Attitude

Attitude represents the positive and negative evaluations that an individual holds of objects. It is assumed that attitudes encourage individuals to act accordingly. Thus, a taxpayer with positive attitudes toward tax evasion is expected to be less compliant than a taxpayer with negative attitudes. Attitudes towards tax evasion are often found to be quite positive (Kirchler et al., 2008). Many studies on tax evasion found significant, but weak relationships between attitudes and self reported tax evasion (Trivedi, Shehata, and Mestelman, 2004).

A model of tax evasion behavior developed by Weigel, Hessing and Elffers (1987) considers social and psychological conditions, including attitudes and moral beliefs about tax evasion's propriety, as antecedents of tax compliance. Data collected from fined tax evaders and honest tax payers showed that attitudes explain in part self reported tax evasion, but are insignificant predictors of actual behavior. However, the correlations between self reported tax non compliance and attitudes are significant but fairly weak. These findings suggest a rather complicated relationship between tax evasion and attitudes. Nevertheless, one can be confident in a general prediction that if tax attitudes become worse, tax evasion will increase (Lewis, 1982).

The attitudes are important for both the power and the trust dimension. On the one hand, favorable attitudes will contribute to trust in authorities and consequently will enhance voluntary tax compliance. On the other hand, attitudes towards the authorities will be relevant for the interpretation of the use of power as benevolent or malicious. Tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge (Kirchler et al., 2008).

Norms

Besides attitudes, norms are important determinants of tax compliance. Behavioral intentions are determined also by subjective norms (Ajzen, 1991). Norms are behavioral standards on three different levels: the individual level, the social level and the national level (Kirchler et al., 2008). On an individual level, norms define internalized standards on how to behave. Individual norms are related to moral reasoning, authoritarianism and machiavellianism, egoism, norm dependency and values. There is considerable overlap between individual norms, values and tax ethics: the more developed the moral reasoning or tax ethics, the more likely is voluntary compliance (Trivedi et al., 2003).

On a social level, norms are usually defined as prevalence or acceptance of tax evasion among a reference group (Wenzel, 2005). Social norms are related to the behavior of reference groups, for example friends, acquaintances or vocational group. If taxpayers believe that non compliance is widespread and approved behavior in their reference group, they are likely to be non compliant as well. The relationship between social norms and tax compliance is complex. Wenzel (2004) argues that social norms should elicit concurring behavior only when taxpayers identify with the group to whom the norms are ascribed. Taxpayers then internalize the social norms and act accordingly.

On a level of national norms, norms become cultural standards, often mirrored in the actual law. Several authors suggest that trust in political leadership and administration will lead to voluntary tax compliance when favorable national norms are established (Fjeldstad, 2004). In general, if the norms held by taxpayers favor tax compliance, voluntary tax compliance will result. Thus, norms encompass both power and trust. First, national norms find their expression in tax laws and the role given to tax authorities, having a direct influence on their power. Second, social norms such as the belief that tax



evasion is a petty crime and widespread hinder the work of tax authorities, in particular when there is no countervailing norm of community. A norm where all citizens are perceived as contributing their fair share would certainly help to increase trust in the authorities (Kirchler et al., 2008).

Fairness

Another factor that seems a moral compass for discussion on tax compliance issue is fairness of tax system (Rawlings, 2003; Taylor, 2003). A conceptual framework for fairness considerations suggests three areas: social psychology, distributive justice, and procedural justice. Social psychology refers to the exchange of resources in terms of benefits and cost. Procedural justice refers to the process of resource distribution; and retributive justice refers to the perceived appropriateness of sanctions in the case of norm breaking (Kirchler et al., 2008).

Distributive justice can be interpreted on an individual, group, and societal level. The individual level suggests that taxpayers are concerned about the fairness of their outcomes, and prefer to be treated relatively to their merits, efforts and needs. If an individual's tax burden is heavier than that of comparable other individuals, tax compliance is likely to decrease. On a group level, taxpayers are concerned about the fairness of outcomes of the group and want a fair treatment of their group relative to other (income) groups (Spicer & Lundstedt, 1976). If a specific group perceives its tax burden as heavier than that of another group, tax non compliance is likely to increase within this group (Juan, Lasheras & Mayo, 1994). The societal level reflects how taxpayers are concerned about the fairness of the outcomes of the whole nation. If the tax system is perceived as unfair, tax non compliance is likely to increase (Cowell, 1992), whereas a system experienced as fair might increase trust and consequently increase voluntary tax compliance.

In a procedural justice, the components essential for perceived fairness are neutrality of the procedure, trustworthiness of the tax authorities, and polite, dignified, and respectful treatment of tax payers (Tyler & Lind, 1992). Comparisons again are made on the individual, group and societal level. On the individual level, taxpayers consider the treatment by the tax authorities, information provided, costs regarding compliance and administration, and the dynamics of allocation of revenues. It is argued that increased information related to tax law and explanations for changes can increase fairness perceptions of tax system (Carnes & Cuccia, 1996; Wartick, 1994).

Perceived procedural justice on the individual level and a culture of interaction are important for building up trust (Job, Stout and Smith, 2007). On the group and societal level, taxpayers consider the neutrality of tax officers regarding subgroups, such as vocational groups or income groups. If tax authorities and officers treat taxpayers equally, in a respectful and responsible way, trust in the government and thus voluntary tax compliance is likely to increase on the individual, group and societal level.

A retributive justice, unreasonable and intrusive audits and unfair penalties lead to negative attitudes toward the tax office and taxes in general (Spicer and Lundstedt, 1976; Wenzel and Thielmann, 2006). Thus, unfavourable retributive justice perceptions could lead to increased distrust and consequently to increased tax non compliance. Although justice research has not always yielded consistent evidence for the impact of justice perceptions on tax compliance, perceived justice might increase voluntary tax compliance.



A perceived fairness is connected to the trust dimension because a just treatment of taxpayers (i.e., distributive and procedural fairness) helps to build and maintain trust. Retributive justice is connected to the power dimension, because it depends also on detecting and fining wrongdoers. In turn, an inconsiderate exertion of power that is perceived as intrusive can reduce trust. In conclusion, some of the major factors discussed on tax compliance would gain from considering them within the “slippery slope” framework and its interaction of the power and trust dimension (Kirchler et al., 2008).

3. Methodology

This paper relied on secondary source of information and thus focused on conceptual exploration, review of theories and critical analyses of past studies. The study made series of review of prior studies that are of relevance and were sourced from texts and published journals online.

4. Discussion

Current Trends in Sustainable Tax compliance.

New forms of taxes are on the rise with existing policies being modified to reflect changing social, economic and environmental trends. Governments are constantly seeking new and more accurate ways of securing tax revenues and financial information. Taxes levied on goods and some services have become much more important sources of revenue due to the aging demographic and the high cost of providing social security and social care. The ever-expanding appetite for consumer goods and the lucrative services economy provides an excellent revenue opportunity for governments who are now implementing measures to secure their incomes and prevent fraud. This is evident in the number of initiatives focusing on e-invoicing and e-reporting designed to ensure taxes are paid on an ongoing basis.

The introduction of Artificial Intelligence (AI) to tax administration across the world has seen heavy investment in digital transformation to enhance tax compliance, reduce fraud and improve overall efficiency. Increased emphasis on carbon taxation in recent times have given rise to a number of taxes dedicated to environmental sustainability and carbon consumption steadily increasing. The motivations are twofold: there is a clear desire to reduce CO₂ emissions and control climate change but in addition, environmental management tax is an excellent revenue source for government.

Studies have shown that non-economic factors as being more influential on voluntary tax compliance behaviours of taxpayers. The more the taxpayers see and have a feeling of what the taxes are being used for the more they are ready to fulfill their tax obligations. This is further seen in the fact that develop countries have visible sights of what taxes are being used for unlike in developing countries, which is the reason behind the wide gap in the tax collection (compliance levels) of develop countries and the developing countries. In a bid to reduce this wide gap and bring about improved tax collection, the current Nigerian government has set up a Presidential Tax Committee who are working on simplifying the existing complex tax system in the country by trimming down the multiple taxes within the Federal, State and Local governments.

5. Conclusions

Matters relating to taxation are of great importance to the people and government of any nation. This has been confirmed by the reviewed literature and it thus justifies the considerable interests given to the subject of tax compliance by governments, tax authorities and academia. The review of literature has shown that it is almost difficult to have 'one universal' perfect way for achieving compliance behavior or solution to achieving optimal tax compliance, as several factors usually influence individuals'



decision to comply with tax payments. These factors typically vary from location to location, presence of different existing pertinent factors and from one situation to another.

The available factors for studying tax compliance have (individually and collectively) provided insights into understanding taxpayer compliance, as such, tax compliance researchers can make a choice or a combination of factors that best suits their environment and situations facing them. Tax fairness seems to involve at least two different dimensions the first relates to the benefits one receives for the tax given; the second dimension involves the perceived equity of the taxpayer's burden in reference to that of other individuals. This second dimension relates to taxpayers' perceptions of the vertical equity of the tax system. If a taxpayer were to feel that they pay more than their fair share of tax when comparing themselves to wealthy taxpayers, they are more likely to see paying tax as a burden than a taxpayer not concerned about these issues.

A major conclusion that can be drawn from all the factors of tax compliance is that compliance (or non-compliance) is influenced by both economic and non-economic factors, though the non-economic factors have greater influence due to the increase enlightenment of taxpayers (information availability), also the global trend of convincing rather than coercing. There avail many options in respect of actions to taxpayers globally. It is therefore pertinent that tax administrators and academics pay more attention into developing effective tax systems that will consider the possible applications of the non-economic factors that individuals consider when making their sustainable tax compliance decisions.

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