

# How do we pay tax? - Taxation-related behaviors

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*Abstract: The tax systems, the taxation are usually complicated and complex asset systems, the taxpayers' behaviour is complex too, behind the tax evasion, tax avoidance and tax denial there are also very complicated, intricate phenomena. The purpose of this paper is to describe the possible patterns of behaviours and attitudes in the background of this phenomenon from the aspect that - by economic psychology and behavioural economics coming into the foreground how the classical economic model changed (maximizing the expected utility) over the past decades.*

*Keywords: tax evasion, tax denial, tax avoidance, tax moral*

## 1. Introduction

Tax is one of the largest source of income in state budgets, so taxation plays a significant and determining role in the life of all economic actors. It affects all members of society without exception, directly or indirectly. Taxation is a very complicated and complex system of tools, so behind tax evasion, tax avoidance and tax denial there are often very complicated, tangible phenomena. Taxation has been a concept since the birth of states. Different and very varied forms of tax evasion have evolved in different historical periods. In a rapidly changing economic environment, tax-related abuses are difficult to classify because human ingenuity knows no limits. In order to reduce or eliminate abuses, it is important for organizations and public bodies assigned to taxation to be more prepared and efficient.

The 1988 tax reform has resulted in a complete economic and social change of regime in Hungary. In our economy, there was a noticeably gradually chaotic situation. Based on an analysis of data of income tax declarations and VAT returns, it seems like there is still a very high level of tax avoidance, the series of

VAT scams are typical, the lack of social security contributions and also the high level of black employment. "The ratio of the black economy rose sharply after the change of regime and then declined somewhat in the turn of the millennium, but it is still high from an international aspect, but it fell below 20 percent in 2007" (Belyó, 2008).

Because of these, a very important economic policy objective is to reduce the level of tax evasion and to increase the efficiency of taxation.

"The hidden economy is one of the phenomena that can be found in every market economy, but its level is varied from country to country, and this difference is an important information about the state of the economy, the behavior of economic operators, the acceptance of government and government measures" (Szántó - Tóth, 2001).

In this study - the behavior that goes beyond the microeconomic examinations of tax evasion - I am studying the tax aspiration from an economical point of view, examining the reasons for the decision of individuals to avoid tax payment and the ways in which the hidden economy can be reduced. My aim is to explore as deeply as possible the taxing habits, tax avoidance, tax denial, tax evasion and the behind-the-scenes techniques, causes, behaviors, attitudes and tax moral on the basis of international literature. After the analysis, I expect the cultural environment and the demographic factors (gender, age and marital status) affect the tax moral, and national pride also has a positive impact on it. I combine my hypotheses with studies carried out by researchers on the subject, taking into account the most important international research and synthesizing the results obtained.

## **2. History, special literature review**

I find it very important to analyze, interpret and define concepts of tax avoidance, tax denial and tax evasion. It is likely that we cannot draw a sharp line between these concepts, but we must be able to distinguish completely illegal forms of tax evasion from the preferential taxation options and the "loopholes" even provided by the tax system which are more likely to be attributed to gaps in the tax law. Action against the latter category is also somewhat simpler than in the case of tax evasion, since it is possible to modify the tax rules by making it more difficult to avoid any rules. However, the fight against tax evasion is much more difficult, the extent of which can only be reduced by increasing the effectiveness of official controls, or by improving tax morals. However, the actions behind all categories result budget deficit, so in these terms these concepts become more confused, while legally, the boundaries may be much sharper. The concept of tax evasion is constantly changing in laws, psychology, sociology and economics. Already in the

ancient periods and in the middle Ages there were various sanctions for tax evasion.

Tax revenues are the major part of our budget, to which we all have a civic obligation to contribute in the ratio of our assets and income. The tax is in fact a statutory, non-refundable, non-repayable, general, financial service intended to finance expenditures of the state. Taxpayers perform their tax liability according to the rules of self-taxation, which means that taxpayers themselves determine the tax base and the amount of tax payable and then send the tax return to the tax authority and we, for ourselves will arrange the payment of the tax to the appropriate treasury account. However, the amount of tax levied can be influenced if we do not provide data on the real tax base or we do not include the actual tax base in the contracts. However, this system of tax declaration and tax payments may give reason to very serious abuses. All this, differently, but affects all members of the society. International experiences also show that reducing the tax burden itself does not reduce the size of the hidden economy, in the long run, only improving the autonomy and motivation of actors can bring lasting results. While most of the companies are struggling to mere existence in Hungary today, they want to keep as much as possible of the revenue they generate and therefore introduce more inventive techniques to tax evasion. Based on statistic estimates, we can see that a tax base corresponding to one-third to one quarter of GDP disappears in our country after the comparison of the tax returns and the amount of tax payments. "According to the CSO's report, the size of the black economy in the ratio of GDP is now 15%. Similar results were obtained by Zoltán Pogátsa (Pogátsa, 2012), who defined this ratio at around 11-18%. However, according to research by Pál Belyó, the size of the hidden economy is around 20-25% (Belyó, 2008, p. 114)" (Hauber, 2013). On international level, we can see that "the proportion of the informal economy in the United States is the lowest, about 8-9 percent of the gross national product. In the Western European countries, the share of the gray economy is higher, near to 15 percent. According to calculations, the share of illegal economy in the Czech Republic and Slovakia is below 20 percent, while in the other Central and Eastern European countries it is higher with 5 to 10

percentage points" (Belyó, 2008). Observing this data, we can conclude that fighting and reducing the scale of tax evasion and the hidden economy is an important political tool for all countries. However, it is to be noted that there is an optimum level of hidden economy in every economy, where it is not worth to increase further and to reduce the fiscal expenditures on tax audits" (Szántó-Tóth, 2001). The main question is whether the willingness to pay taxes or the tax moral can be improved and, if so, how.

"Motivations, preferences, interactions, passions make economic games much more complicated and colorful than the textbooks used in basic economics courses show. However, the extension of preferences does not constitute an unbreakable barrier to economic analysis. Economics can handle altruism as well as selfishness, likewise envy and benevolence" (Hámori, 1998).

Due to the analysis focuses on economic actors, individual decision-makers, and the behavioral characteristics, decision alternatives and economic reactions of these actors, the classical economics claims must be expanded with sociology and behavioral fields, too. "To understand how economies work, how to control them, and how to prosper at the same time, we need to understand the conceptual schemes that animate people's ideas and their feelings, those are, spiritual factors. We will never really understand important economic events unless we are faced with the fact that these reasons are mostly psychological (Akerlof-Shiller 2011). Akerlof and Shiller consider themselves the devotee of Keynes. "Keynes writes in his epoch-making work published in 1936, *General Theory of Employment, Interest and Money*, that the motives behind economic and investment decisions are far from being rational. Keynes of course accepted that most of the business activity was born from rational considerations - but he also thought that many of these were motivated by animal spirits" (Akerlof - Shiller, 2011). Spiritual phenomena have to be considered as effective economic factors" (Garai, 2003).

### **3. Measurement possibilities of the shadow economy**

In general, the shadow economy can be measured in two ways: by micro-level surveys, questionnaires, interviews, or indirect approaches such as the demand for currency and hidden variables, using macroeconomic indicators. The direct estimation of the hidden economy is mostly based on the composition of the Multiple Indicators Multiple Causes (MIMIC) and the currency demand method. MIMIC means that there are more indicators, more reasons, that is to say, the shadow economy, taking into account more aspects. The MIMIC procedure assumes that the hidden economy is an observable phenomenon (a hidden variable) that can be used to estimate the measurable causes of illegal employment such as tax burden and regulatory intensity, indicators of illegal activity, demand for currency, and official working hours. The disadvantage of this method is that it is only a relative estimate of the development and size of the hidden economy. In addition, there is a large number of World Values Survey (WVS) and European Values Survey (EVS) data sets that enable the conduct of empirical studies within the subject. It contains factors on an individual level that may affect citizens' attitudes towards paying taxes. The WVS is a set of data on the world-wide survey of socio-cultural and political attitudes that contains the value of comparative data and across belief systems across the world. The EVS data set is a similar survey focusing solely on EU countries. Both surveys have been widely used by political scientists and economists. Using the World Values Survey (WVS) and the European Values Survey (EVS) data series, we can analyze the impact of social norms and government institutions by controlling the personal factors in a

multiple regression analysis where tax morals are subordinated variables. Although all methods have weaknesses and strengths that will certainly prevail in the estimates of the hidden economy, it is obvious that the shadow economy cannot be measured accurately. Macro-level estimates from the MIMIC model and demand for currency are considered to be the upper limit of estimates, while micro-level estimates are considered to be the lower limit of estimates.

#### **4. The relationship between tax environment and tax moral**

In recent years, more research has been exploring that values, societal norms and attitudes differ from country to country, and that these differences have a measurable impact on economic behavior. One area where such studies are of particular importance is compliance with the tax liability (Alm - Torgler, 2005).

There is considerable evidence that coercion efforts may increase compliance with tax rules, but extreme punishments may even have counterproductive effects - resulting in lower tax payments and the loss of general trust in state institutions. Furthermore, it has also been observed that compliance with the tax liability is different in several countries and cultures. There is considerable literature that suggests compliance with the rules is influenced by social norms (Elster, 1989; Naylor, 1989). To develop tax-reduction policies, it is essential to understand the behavioral attitudes behind the decision-making of tax compliance. It is desirable to develop tax policies that encourage tax compliance within the existing tax system. If the individual attitudes of compliance are dependent on social and cultural norms, then improving these norms may be a desirable political option. Compliance with the tax liability is a complex behavioral problem and its examination requires to use different methods and data sources, as each asset has its advantages and shortcomings. (Cummings at al., 2004) report on their laboratory tests in South Africa and Botswana using the same tax reporting report in all experimental environments. The willingness to pay tax has been studied using both empirical data and data obtained from laboratory experiments. Survey data allows many socio-economic, demographic, and attitudinal variables to be included in the use of multivariate analyzes. Both empirical and laboratory data show that cultural norms have an impact on tax willingness to pay.

Kirchler's 1997 study also examines the attitude of taxpayers. Reliance on norms, egoistic and altruistic value orientation, tax mindset and tax morale, and demographic characteristics were assessed by questionnaires. The results show that value orientation, age and dependence on norms are also related to general tax attitudes. The taxation mentality and tax morale, as Schmolders (1966) have determined, depends on the age of respondents. This result was confirmed on

several occasions in the relevant literature (Kirchler, 1996; Strümpel, 1966). Arriving to their older age, taxpayers can adapt to the tax system and learn to accept it. It can be assumed that these results are also influenced by the fact that older people rely more heavily on the pension system and other state support networks than young people do, who feel that their freedom is limited by tax payments and they do not perceive that the use of paid taxes or redistribution would be fair or feel inappropriate the government feedback on the use of tax burdens. In a latter Kirchler (1999) study, we find that personality characteristics, ideological and religious values influence tax moral.

Lewis (1982) and Groenland and Van Veldhoven (1983) report that personality characteristics (such as dependence on norms), ideological and religious values, and moral orientations influence tax behavior. According to Kirchler (1999), taxes limit the freedom of individuals to make autonomous decisions about their income. For this reason, they are likely to respond to opposition to their freedom of restraint or perceived limitations. This inductive resistance is due to the perceived restriction of freedom, probably due to taxpayers' attitudes, tax evasion and tax behavior changes. The age of respondents in the survey, the demographic characteristics of the participants, such as the gender of the respondents, also significantly influenced the tax attitudes.

According to (Kirchgässner, 2010) the taxation moral depends on religious traditions and the relationship between political and religious authorities. While McGeey R. W. points to subjective assessments directly related to the tax system, Torgler B. to specific factors such as age, gender, marital status and employment status and, moreover, more general assessment indicators such as trust in the government and the legal system. Both have a significantly positive effect on the tax moral. The same applies to the degree of decentralization, while the efficiency of the public sector has a negative effect. In addition, cultural factors and especially religious behavior play an important role: religious people have a higher tax moral. For example, research in Canada has produced results that Catholics have lower tax moral than Protestants, but this is still an open question because the difference is statistically not significant.

In 2006, Schneider and Torgler conducted a unique study of the moral of citizens in three multicultural European countries: Switzerland, Belgium and Spain; based on the World Values Survey data, using the Wald-test. The results show that cultural and regional differences affect tax dignity. Based on the Swiss survey, it has been found that culture plays a significant role in determining the individual tax moral. Examining national pride, they also came to the conclusion that they also have an impact on the tax moral. With respect to the other control variables, the trend was observed in the case of women that the tax moral was significantly higher than in case of men. In addition, people with 50-64 years of age tend to have a greater willingness to pay than for other age groups. In addition, pensioners and married people experienced a higher tax moral than single persons. In the case of the Belgian surveys, the role of culture in the tax willingness to pay, as well as

national pride and democratic attitudes have been studied. The results do not show statistically significant differences between the different cultural groups as it is in Switzerland. Similarly to the Swiss results, national pride and democratic attitudes in Belgium have a significant positive impact on tax moral. It is worth to mention that national pride and democratic attitudes have more effect on the tax on the moral of the French-speaking population than among the Flemish population. As far as demographic variables are concerned, the particularly high taxation moral in the 50-64 age group suggests the positive impact of age. Moreover, women clearly show higher tax moral than men, and married people are also at higher tax morals than single people, like the Swiss example. According to the multivariable analysis in Spain, the Wald test shows that culture plays a significant role in defining individual tax moral, and national pride and democratic attitudes have a significant positive impact on it. The results on control variables suggest that women are more accountable for tax payments than men and widows show the highest tax moral from private individuals. The study's findings show that cultural and regional differences affect both taxation moral in Switzerland and in Spain. In addition, in all three countries, results have emerged that national pride and democratic attitudes have a positive impact on the willingness to pay tax, which can prove that the higher legitimacy of political institutions leads to higher tax compliance.

(Belyó, 2004) conducted studies on tax morale among the respondents, there were companies who were also in the conduct of economic actors to explore the factor that could help to suppress the hidden economy. According to 13 percent of the participant in the survey say, the current economic standards change requires at least one generation in time. While 9% say that this is not enough, there will always be companies that find and use the loopholes, and 4 percent of them do not see a company having any interest in changing the current situation.

### **Summary**

Comparing my hypotheses to the investigations of the researchers dealing with the subject, I find that despite the fact that tax policy is the most obvious means of enforcing and regulating tax payments; the policy of deterrence, that is, the higher the penalty and the fines, the coercion or counter effect- from taxpayers. This is read in Cummings et al. (2004), that coercion and extreme high taxes and penalties may result in lower tax payments and, in general, loss of trust in state institutions. Based on their experiments in Botswana and South Africa, it is clear that cultural norms have an impact on the willingness to pay tax. (Kirchgässner, 2010), we find that cultural factors, especially religious behavior, play an important role in tax payment propensities. A similar result is obtained from AlmTrogler (2005) examining the differences between cultural differences and tax moral - the US and Europe - who have concluded that it is worth noting that the US tax moral exceeds each country's because better treatment of taxpayers and authorities unavoidable interference, the tax moral proved to be more effective. The impact of cultural factors on tax morals at Schneider and Torgler (2006) also

appear in surveys in three multicultural European countries, Switzerland, Belgium and Spain. Although there was less impact in Belgium, it can be demonstrated in Switzerland and in Spain that the cultural environment has a significant impact on the tax willingness to pay. For all three countries, the results show that in addition to cultural factors, national pride has a positive impact on tax moral. Within demographic factors, for all three countries, results have been achieved that women's willingness to pay for tax is higher than men's. In the case of the Swiss and Belgian surveys, there was a higher tax moral in case of married people, and the Spanish results showed that the widow's willingness to pay tax was higher. In addition, there are countless studies on demographic factors that have a significant impact on tax willingness to pay. The findings of Kirchler (1996, 1997, 1999),

Schmölders (1966) and Strümpel (1966) also show that age, demographic characteristics of participants, such as gender, are also related to general tax attitudes, and tax moral, depends on the demographic characteristics of respondents. He also came to the same conclusion as regards the demographic factors (Kirchgässner, 2010), who in the context of tax moral also points to specific factors such as age, gender and marital status.

Based on these international research experience, my hypothesis can be verified, that is both the cultural environment and the demographic factors (gender, age, marital status) have an impact on tax moral. With regard to my third hypothesis - that national pride has a positive impact on the willingness to pay tax - fewer literature data are available, so this requires further research.

### **Conclusions**

Because of their tax sovereignty, individual economies have their own tax systems, but because of the ever-increasing international trade relations they try to harmonize domestic legislation with international law. Due to the high level of globalization and the expansion of the member states of the European Union, competition has crossed borders, and competitiveness has become a determining factor in international relations. Accession to the EU requires a certain harmonization obligation for the acceding countries, so it is in any case a condition to modernize the tax system of the acceding countries. The institutional system of the European Union has a special place in the law of nations. Due to its special nature, it is not comparable to international organizations nor to the institutional system of the states, as both intergovernmental and supranational elements occur in its operation. Both the emergence of a single European market and the abolition of border controls and the development of Community trade have contributed greatly to the spread of tax avoidance, tax evasion and tax fraud. This will result in a reduction in budget revenue, a violation of the principle of fair tax burden and the distortion of Community competition conditions. For this reason, it is very important for Member States to develop tools for cooperation, mutual exchange of information, appropriate expansion and coordination of administrative and legal instruments, presence in tax inspections in other Member



States and ongoing exchange of experience. "In states where taxpaying is easier, more revenue can be achieved, there is greater confidence in the taxpayer. High tax rates, with high administrative burdens decreases the trust. States most often reduced tax administration burdens over the past few years by introducing self-sufficiency, electronic reporting, and stakeholder engagement "(Herich et al., 2011). There are countless Hungarian literature reviews and my own opinion is that the Hungarian tax system is very complicated, opaque, modified too often, with no predictability or predictability. In our country, tax laws varying frequently, year after year, sometimes even several times within a year, creates uncertainty for taxpayers and are difficult to adapt the changes. Perhaps this is one of the main problem of the Hungarian tax system today that there is no foresight. Gáspár et al. (2004), there is no unique appearance in horizontal and vertical equity in the Hungarian tax system due to the exceptions and exemptions, the different taxation of individual income, and the tax system cannot be considered effective, transparent and enforceable. According to Szerb and Ulbert (1998), the most frequently criticized feature of the Hungarian tax system is the high tax burden, the over-taxation of the middle class, the complex and continually more and more unsettled system, the tax system and the ratio of the black / gray economy to about 30% of the GDP, unsettled expenses, frequent wasting and corruption. According to Hetényi (2004), the tax burden of the Hungarian tax system is high, it does not stimulate development, and it is too complicated. Kátay (2009) also characterized the Hungarian tax system very complex and opaque. In addition, I consider it important from the view of tax moral to have good relations between citizens and the state, the reliability of the government and the stability of the tax system. It is very important for the willingness to pay taxes that citizens have greater role to play in managing the country, managing the government as a client, as a partner. Most importantly, for a tax system to be as reliable, stable and predictable as possible, taxpayers should be able to plan long-term and receive adequate feedback on the usage of the tax burden paid.

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