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IS TAX LITERACY IMPACTING ON TAX BEHAVIOR?

Literature
review

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Abstract

As reported by the specialty literature, among the multitude of economic, psychological, sociological and political variables influencing tax behavior, the level of tax knowledge or tax literacy is said to impact on compliance attitudes and decisions of potential and current taxpayers. Via an extensive literature review, the present paper pinpoints the idea that taxpayers who possess basic knowledge in matters like taxation, public goods provision, state budget structure, fiscal policy or tax laws understand the importance of taxes for financing modern societies and are more willing to honestly declare all revenues.

1. Introduction

Nelson Mandela, the South Africa leader, used to say that “education is the most powerful weapon which you can use to change the world”. According to empirical investigations conducted in a manifold of areas, education is a catalyst for change, as it alters thoughts, beliefs, attitudes and ultimately behaviors (Asch & Shore, 1975; Bernheim & Garrett, 2003; Bernheim, Garrett & Maki, 2001; Cacioppo, Petty & Crites, 1994; Chatterjee, Green-Pimentel & Turner, 2010; Gray et al., 2009; Greenspan, 2003, 2005; Hungerford & Volk, 1990; Joo & Grable, 2000; Kim & Garman, 2003; Lyons, Chang & Scherpf, 2006; Margolis, 2013; Rustad & Smith, 2013; Tatto, 1998; Thompson, 2002; Varcoe & Wright, 1991).

In the same vein of Mandela, the present article emphasizes the idea that tax literacy may change taxpayers’ world of perceptions and behaviors. Hence, the following set of questions arises: Why is tax behavior research important for the development of modern societies? Where does tax literacy stand among the determinants of tax behavior? Can tax authorities design appropriate strategies to improve compliance behavior by educating taxpayers and increasing their tax literacy level?

The paper features the following structure. The second part offers insights into the tax behavior literature. The third part brings forth a brief literature review regarding the impact of tax literacy on contributors’ behavior with respect to fiscal obligations. The fourth part synthesizes findings, thus paving the way for future avenues of research.

2. Insights into the tax behavior literature

In the commencement of their historical research endeavor aimed at identifying the sources of power, affluence and destitution among nations, Acemoglu and Robinson (2012) give a telling example on the importance of institutions for the wellbeing of citizens. They relate about one city sharing an identical cultural heritage, with dwellers residing in two different countries separated by only a fence, i.e., *Nogales* - Arizona (USA) and *Nogales* – Sonora (Mexico). While the citizens of the former enjoy the benefits of a well-functioning public goods system, the citizens of the latter struggle with a faulty and corrupt system to make ends meet.

Analyzing this situation via the taxation lens, it can be presumed that one of the reasons for which institutions function properly in *Nogales*, Arizona, is an efficient collection of taxes stemming from a relatively high tax compliance level – which leads us to the topic of the paper.

Generally, various institutions within the public system are financed through taxation and are the

prerogatives of modern societies. Governments are able to provide and maintain a certain living standard because citizens comply with the tax law.

For that matter, paraphrasing Paul Samuelson, it could be stated that tax money represents the blood irrigating the public goods system. As citizens fail to report honestly their revenue (for a number of reasons) and state budgets become depleted, life conditions in general worsen. Malfunctions within the public system reverberate in other society areas, thus hindering economic, social or political progress.

Therefore, considering the importance of taxes for modern societies, social researchers have been extensively investigating tax behavior by means of a comprehensive methodological apparatus: *theoretical approaches* (Allingham & Sandmo, 1972; Batabyal & Beladi, 2010; Graetz, Reinganum & Wilde, 1986; Slemrod, 2001; Srinivasan, 1973, Yaniv, 1994; Yitzhaki, 1974, 1987); *experimental insights* (Baldry, 1986; Bosco & Mittone, 1997; Coricelli et al., 2010; Cummings, Martinez-Vasquez & McKee, 2006; Feld & Tyran, 2002; Kogler et al., 2013; Mittone, 2006; Torgler, 2002; Verboon & van Dyke, 2011); *national or cross-cultural surveys* (Alm & Torgler, 2006; Gërxhani, 2007; Hennighausen & Heinemann, 2014; Richardson, 2006); *literature reviews* (Australian Taxation Office, 2012; Batrancea, Nichita & Batrancea, 2012; Devos, 2014; Hynes & O’Connor, 2014; Kamleitner, Korunka & Kirchler, 2012; Kirchler, 2007).

Consequently, various categories of tax behavior determinants have been singled out. As can be seen in Figure 1, taxpayers’ decisions to follow or not the tax law can be influenced (among others) by economic, psychological, sociological or political factors.

3. To know or not to know: Brief literature review on tax literacy

Tax behavior entails two main typologies: *compliance*, which can be either voluntary or enforced (Kirchler, Hoelzl & Wahl, 2008); *noncompliance*, which can be either tax avoidance or tax evasion. According to the literature, one of the sociological factors influencing tax behavior is *tax literacy* or the level of tax knowledge held by contributors (Djawadi & Fahr, 2013; Hofmann, Hoelzl & Kirchler, 2008; Kamaluddin & Madi, 2005; OECD, 2013). Namely, the amounts of taxes collected by authorities increase significantly when taxpayers know more about the tax law (Palil & Mustapha, 2011), tax systems (Wartick, 1994) or become aware of the negative effects generated by tax evasion (Holler et al., 2008).

At the present time, when information is doubling in size every two years (Turner et al., 2014) and markets are globally connected, the level of tax

knowledge has become extremely important for both authorities and taxpayers. On one hand, taxpayers need to be connected to the latest advances of the tax law in order to adequately run their activities. Moreover, they must be aware of the effects generated by their tax behavior on state budgets.

As a matter of fact, tax behavior cannot be amended if this awareness lacks. Drawing a parallel with health research results based on the social cognitive theory, one could see that the conclusions stated by Bandura (2004: 144) also apply in the tax behavior case: “knowledge of health risks and benefits creates the precondition for change. If people lack knowledge about how their lifestyle habits affect their health, they have little reason to put themselves through the travail of changing the detrimental habits they enjoy”.

To make voluntary tax compliance salient among taxpayers, authorities may turn to different strategies for increasing their level of tax literacy. The involvement of formal schooling institutions (i.e., primary schools, high schools, colleges) could be of help in educating potential taxpayers (for a detailed overview, see OECD, 2013).

Moreover, based on the fact that behavioral changes can be generated directly by media or indirectly via interactions with social systems (Figure 2), tax authorities may design smart media campaigns informing taxpayers of the latest changes in the tax law or the importance of financing public goods systems via honest taxpaying (for a detailed overview, also see OECD, 2013). Once tax information is promoted via media, it may also easily reach social systems (e.g., family circle, friends, acquaintances) in order to be then acquired by the regular taxpayer.

4. Conclusions

Stressing the significance of taxes for the development of modern societies, the present article offers insights into tax behavior research, with a special focus on tax literacy. Viewed as the level of tax knowledge acquired by taxpayers through different channels (i.e., schooling, interactions within social network, media), tax literacy determines to a certain degree the level of taxes collected in a modern society.

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Figures

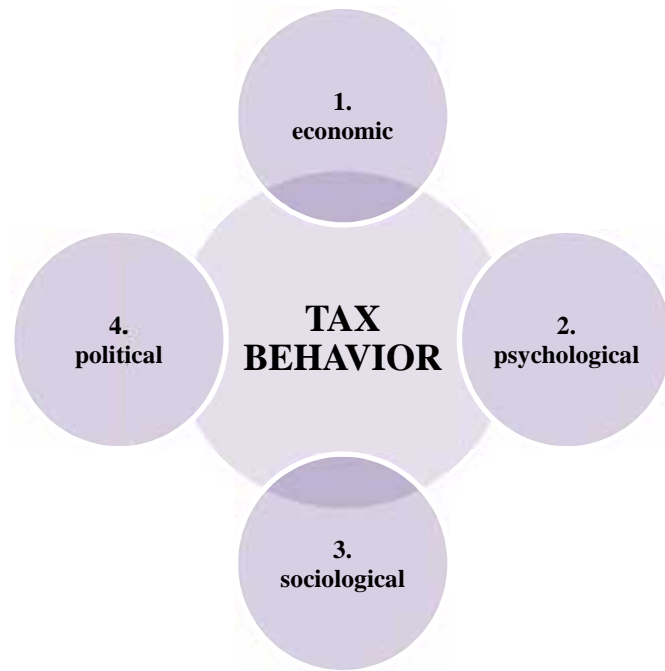


Figure No. 1. Main factors influencing taxpayers' behavior

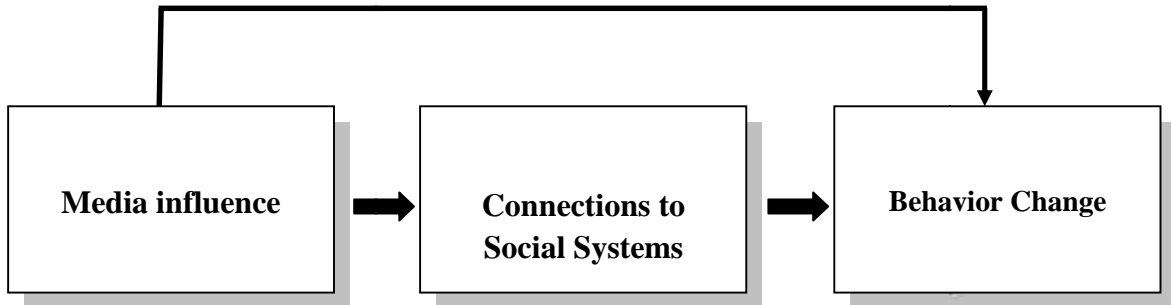


Figure No. 2. Dual paths of influence in behavior change (Bandura, 2004: 150)