The Effect of Friendly Persuasion and Gender on Tax Compliance Behavior

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ABSTRACT. Friendly persuasion, in contrast to deterrent measures like tax audits and penalties on underreported taxes, is a positive and possibly a cost effective method of increasing taxpayer compliance. However, prior studies have failed to show that friendly persuasion has a significant impact on compliance (Blumenthal et al., 2001; McGraw and Scholz, 1991). In our study, in contrast to prior studies, we examine the impact of generating and reading reasons supporting compliance as friendly persuasion on individuals’ income reporting behavior as well as control for gender effects. Specifically, we predict an interaction effect between friendly persuasion and gender on compliance behavior. We carried out a 2 (friendly persuasion and control) × 2 (men and women) full factorial experiment, where participants earned $30 by completing two questionnaires. Participants in the friendly persuasion group were required first to generate and second to read a list of reasons why they should comply fully. Afterwards, participants in both groups were asked to report the income they earned and pay tax on the reported income. The results show a significant main effect for gender as well as a significant interaction effect between gender and friendly persuasion on income reported. Women in the friendly persuasion group reported significantly higher income compared to men in that group. Other comparisons were not significant. Policy implications for increasing taxpayers’ ethics and compliance are highlighted.

KEY WORDS: generating and reading reasons, income tax reporting, normative appeals, personal consequences.

I. Introduction

Tax evasion is a form of illegal behavior involving a moral (ethical) decision where personal benefits come at the expense of impersonal others or society as a whole (Kaplan et al., 1997). Therefore, increasing the level of income tax compliance, i.e., tax ethics, is an important issue for the tax authority of countries where a large proportion of government spending is funded by taxes collected. However, many tax authorities have a limited budget to spend on the various programs designed to increase tax compliance such as aggressive enforcement measures and friendly persuasive techniques. Therefore, discovering which approach or combination of approaches is more effective is therefore important for the efficient use of the limited budget in increasing individuals’ tax ethics.

Aggressive enforcement measures include auditing selected taxpayers and prosecuting alleged tax evaders. Friendly persuasion refers to appeals or influences and may include normative appeals and appeals that promote compliance out of self-interest by providing information about the personal consequences to the individual consequent to noncompliance, whether social, ethical, or legal. While aggressive enforce-
ment measures have traditionally been used to increase compliance, the use of friendly persuasion on increasing taxpayers’ ethics has generated some research interest recently. Notwithstanding that these studies (McGraw and Scholtz, 1991; Blumenthal et al., 2001) report that friendly persuasion does not increase compliance, but given its relative economy and the limited compliance budgets of many tax authorities, friendly persuasion warrants further investigation. The first purpose of the present study is to examine, using a laboratory experiment, the effect of friendly persuasion on individuals’ tax ethics using another set of techniques – by requiring individuals to first write reasons explaining why they should report their income fully and second read a list of reasons on why they should do so. Generation of reasons involves individuals writing reasons that either speak for or provide evidence for the chosen behavior, or speak against or point against the alternative behavior(s) rejected (Koriat et al., 1980) and has been shown to be effective in changing behavior in the cognitive psychology and accounting literatures (e.g., Hoch, 1984; Koonce, 1992). This study attempts to extend the use of generating and reading reasons to a tax ethics situation to discover whether these actions will affect individuals’ tax compliance behavior.

The second purpose of this study is to attempt to explain why the use of friendly persuasion did not significantly change behavior in Blumenthal et al.’s (2001) and McGraw and Scholz’s (1991) studies. Due to the nature of their data, neither of these studies was able to control for gender even though the tax literature reports a gender effect on tax compliance behavior and taxpaying attitude (e.g., Scholz and Pinney, 1995; Beron et al., 1992; Kinsey, 1992; Smith, 1992; Steenbergen et al., 1992; Spicer and Hero; 1985). Because of women’s growing importance in many economies and as taxpayers, we examine whether the effect of friendly persuasion on taxpayers’ income reporting decisions is gender specific.

This study contributes to the literature by examining the use of another friendly persuasive technique – generating and reading reasons supporting compliance – on tax compliance. The results from this study also provide a better understanding of the condition under which the use of friendly persuasion is effective by examining whether it has gender effects and may explain why prior studies report friendly persuasion as ineffective on compliance behavior.

II. Theory development

Friendly persuasion

In countries where a large proportion of government spending is financed by taxes collected from its people, increasing the level of tax compliance among individuals is an important concern of their tax authority. This issue is especially important for the Canada Customs and Revenue Agency (CCRA) given the size of the amount spent by the Government of Canada on welfare measures and social assistance. However, underreporting of income and taxes remains a significant problem in Canada particularly among low-income individuals including students and the young (Hill and Kabir, 1996).

In an attempt to understand tax compliance behavior, prior studies show that individuals’ tax ethics are influenced by various factors (e.g., Alm, 1991), and the extant tax compliance literature reports that individuals pay taxes because they fear detection and punishment. Based on this finding, traditionally, tax authorities (e.g., the Internal Revenue Service of the U.S.) have used aggressive enforcement measures such as audits and prosecution of tax evaders as a way of encouraging tax compliance. Recent research studies and the tax authorities’ own data show that increasing audits and penalties do little to increase compliance if taxpayers are ignorant of these changes (e.g., Scholz and Pinney, 1995). Furthermore, taxpayers as well as policymakers are increasingly averse to overtly intrusive and coercive methods of increasing compliance like increasing the audit rate, as evidenced by the steady decline in the audit rate over the past decade and a half as well as resistance to the administration of later installments of the intense and random audits conducted under the Taxpayer Compliance Measurement Program in the United States. This being the case, tax authori-