

Tax Evasion and the Social Influence Perspective: A Conceptual Model for Palestine

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Abstract--- *Tax evasion is a universal phenomenon that challenges every government worldwide. The purpose of this paper is to propose a conceptual model for understanding factors influencing tax evasion that can be used to study and address tax-related challenges. The proposed model built upon a review of tax studies from behavioural aspect, particularly the social influence perspective. The current review identified four key variables that likely influence tax evasion behaviour of taxpayer. The variables are: corruption, fairness, ethics, and peer influence. The present model adds to the existing body of tax knowledge from behavioural perspectives. As the compliance behaviour is dependent on individual taxpayers, behavioural factors should be given a serious consideration compared to economic factors, as the former is highly dynamic in nature and change over time. In a country like Palestine, with a high uncertainty, the proposed behavioural framework from social influence perspective would benefit tax administrator in understanding and mitigating the tax evasion phenomenon.*

Keywords--- *Tax evasion, Corruption, Tax fairness, Ethics, Peer influence.*

I. INTRODUCTION

Tax builds the government's capability to provide security, meets the basic needs, and fosters economic development. Globally, tax revenue is regarded as the earliest, most sustainable, and dependable source of government revenue which assists governments in coping with their increasing expenditure [1,2,3]. The extent to which the government can generate revenue is dependent on many factors [4]. The taxpayers' willingness to conform with the relevant tax laws is one of the most crucial factors in achieving high tax collection through voluntary compliance. According to Kirchler [5], the failure of the taxpayers to comply with the relevant provisions in the tax law indicates the presence of tax evasion. Tax evasion has been a foremost challenge to tax authorities globally and this practice is getting increasingly difficult to regulate, given the creative nature and dynamic schemes of tax evasion [6].

According to Alm et al. [7], tax evasion is an intentional illegal act of minimizing or complete circumvention of tax liability by the taxpayers. In the same vein, Manea [8] describes tax evasion as the application of an unlawful means to reduce the tax liability by the taxpayers. Thus tax evasion is deemed a crucial issue threatening the revenue

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performance of any government, leading towards fiscal deficits. This likely jeopardizes the implementation of sound government policies including economic policies [9]. Tax revenue is important, but tax administration implies higher importance [10], that ensures maximum possible compliance with tax obligations by taxpayers of all types. Nevertheless, tax administration could be ineffective since tax evasion seems to be more common in the modern era [11].

Tax evasion denotes illegal and intentional actions taken by taxpayers to reduce their legally due tax obligations [12]. Tax evasion is prevalent in both developed and developing countries [13], and is often regarded as a modern financial crime [13]. Tax revenue loss, which is caused by tax evasion, is higher in developing countries compared to developed countries, given the existence of large informal economy in the former [14]. The increasing importance of tax revenue compared to revenue from natural resources has also called researchers attention to conduct more studies in the Middle East countries [15,16].

In Palestine, tax administration is characterized by a high level of tax evasion [17]. The budgets of the Palestinian Authority, right from its inception in 1994, have tremendously indicated a deficit trend throughout. A recent study by Rahhal [17] reported that over USD 350 million budget deficit has been evident, and the public debt also rose to over USD 4 billion. Low tax collection has been attributed as one of the key factor leading to this continuous deficit problem. Eventually, the budget deficit likely has a negative impact on the economic growth [18]. The high level of tax evasion in Palestine is disturbing and gives concern. It has greatly contributed to the occurrence of budget deficit amounting to about 30% of the entire public expenditure of government in 2012 [19]. As stated by Jaber and Al-Riyahi [20], the tax evasion level in Palestine has been earlier projected to be 50% of the entire tax revenue. A more recent report indicated an approximate revenue loss of USD 500 million to the Palestine tax authority due to tax evasion [21] or between USD 500 and USD 600 million [22].

Hence, the issue of tax evasion in Palestine requires further attention and scrutiny. The strange feature of Palestinian tax administration which constrained by the domination of Israeli greatly contribute to the tax evasion [23]. In view of this, it becomes crucial for the Palestinian authority to address the revenue gaps. This is achievable through taking measure to reduce the high tax evasion in the country. Although many researchers (i.e. 17,24,25,26,27,28] have examined the determinants of tax evasion, the predictors of tax evasion are not exhaustive, and research avenues remain exist to better understand the determinants of tax evasion [29].

A number of comprehensive major tax evasion review [30,31] established many key determinants of tax evasion, covering a combination of demographic, economic factors, and behavioral determinants. Other studies have only focused on some behavioral factors [32,33,34], but are extremely limited. The current study proposes a framework that covers key behavioral factors in the context of Palestine. Specifically, it aims to assess the influence of four behavioral factors (i.e. corruption, tax fairness, ethics, and peer influence) on tax evasion from the social influence perspective. The next section presents the review of the literature conducted for the development of the proposed model.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

I. CORRUPTION AND TAX EVASION

Corruption arises when a person pays a particular sum of money in exchange for an illegal act by a public officer [35]. In the view of McClellan [36], corruption has a great tendency of reducing revenue accruable to the government as the taxpayer can evade tax easily by bribing the government tax officials and consequently pay less tax. Hence, the expected realizable revenue by the government signifies the loss of revenue. This invariably reduces government effort, particularly in a cash-strapped developing nation, in discharging its main responsibility of providing public goods and services like security, education, and health.

Corruption is a problem prevalent all over the world, and its roots are still poorly understood by policy makers [37]. It is perceived as an ever-increasing problem in most of the developing countries [38]. It is held that some public officials are often self-seeking and found to have abused their public position for personal gain [12]. Corruptive behaviours of public officials include taking of bribes to issue a license, award of contracts in exchange for money, stealing from the public treasury, and selling government-owned commodities at black-market prices [39].

Perceived corruption has been proven to be a significant predictor of tax compliance behavior [12,40,41]. Corruption deters taxpayer to pay taxes [42], thus restricting taxpayers' compliance behaviour [40]. A higher compliance level could be achieved with a low level of corruption [42]; therefore, the effective control of corruption is negatively related to tax evasion [43]. The theoretical model of tax evasion which incorporates corruption was developed by Chander and Wilde [44], which build upon the game-theoretic approach to tax evasion of [45]. A study by Bilotkach [46] also revealed that corruption of the staff of tax authority in Ukraine has a significant influence on the tax evasion.

According to Picur and Riahi-Belkaoui [43], controlling corruption successfully is negatively associated with tax evasion. This invariably implies a positive relationship between corruption and tax evasion. Similarly, McGee and Maranjyan [47] found that a substantial number of the respondents involved in tax evasion for corruption reasons. Also, Uslander [42] posits that the major determinant of evasion is the perception of the effectiveness of government. However, as argued by Rahmani and Fallahi [48], a rational taxpayer is bound to comply with the relevant provisions of the tax law as against offering bribe to tax officials when the tax payable is greater the cost of the bribe.

Ayuba, Saad and Ariffin [49] state three taxpayers' perceptions that may greatly influence the tax compliance behaviour of the taxpayers. This includes perception on the corruption level in government; on whether the revenue generated from the tax is used judiciously for the provision of social amenities; or on the belief of the taxpayers that they are short charged by corrupt officials of government. Moreover, the taxpayers' justification for evading tax is the premised on the presence of corruption among politicians, the waste, and diversion of tax money [50].

However, some other empirical findings revealed otherwise. For instance, the study of Akdede [51] which concentrated on bribery among government official found that bribery has a negative relationship with tax evasion. This implies that the taxpayers would voluntarily choose to pay the tax instead of corruption when the bribery size is enormous. Also, Imam and Jacobs [52] found that the relationship between corruption and total tax revenue is not

significant. If a country is characterized with less corruption, tax compliance may improve, which invariably means that a perceived high level of corruption may affect tax compliance and the willingness to pay taxes negatively [48].

If taxpayers perceived the government to be corrupted, and that the least amount of tax paid is not judiciously utilized in the form of service provision, the taxpayers may feel being cheated, and this in turn likely affects their compliance behaviour [49]. A high level of corruption can also reduce the tendency of taxpayers in a given state to accept and trust their government in general and comply with tax rules in particular [53].

Furthermore, most of the previous empirical findings showed a positive relationship on the influence of corruption on tax evasion [12,40,42,43,46,47], whereas few studies documented the relationship between them are either negative [51] or an insignificant effect [52]. Thus, in an attempt to improve understanding regarding the relationship between corruption and tax evasion, the current study proposes the followings:

H1: There is a positive relationship between corruption and tax evasion.

II. TAX FAIRNESS AND TAX EVASION

Tax fairness, a variable categorized under perception and attitude taxonomy, has been a part of the considerations in the taxpayers' decision-making [54]. A conceptual framework was designed by Wenzel [55] based on the literature on social psychological fairness and provided three main dimensions of fairness, namely the distributive, procedural and retributive fairness. The perceived distributive fairness was established to influence tax evasion [5,55]. With this line of thought, it was established that taxpayers who have the perception that their tax obligation is greater than that of the other taxpayers are inclined to be less compliant to the tax law provisions [56].

Also, reciprocal inequality and inequity do seemingly undermine the compliance with tax laws. Apart from this, the tendency of taxpayers complying is high where they get a reward in the form of public goods and services which align with the reciprocity postulation of Social Exchange Theory [57]. This view receives the support of many studies that reveal empirical evidence about the impact of the perception of fairness of the tax system to tax compliance of taxpayers [58]. It is argued that there is an unfair tax system, whereby taxpayers perceive that they are overpaying taxes as compared to what other taxpayers are paying or to the value being enjoyed of the public goods and services provided by the government [59].

According to Jackson and Milliron [30], tax fairness consists of at least two different dimensions, and the first dimension appears to involve the equity of the trade - the benefits received for the tax given. The other dimension appears to involve the equity of the taxpayer's burden in reference to that of other taxpayers. Scholars claim that taxpayers are less compliant with a tax system if they perceived that the tax system is unfair [55] or dealings with tax authorities is unfair [60]. Furthermore, tax evasion itself promotes disturbing fairness perception among taxpayers [13]. When some taxpayers involve in tax evasion act, the honest ones continue to pay their taxes because of their strong belief in the fulfillment of tax obligation.

However, when the government or existing ones impose new taxes have increased, the tax burden of honest taxpayers' increases, which might force them to also result into tax evasion [13]. According to Farrar et al. [54], the intentions to comply with tax are highest when interactional fairness is higher. The general belief by the taxpayers and tax administrators is that the growing discontentment with the fairness of the tax system is the fundamental

cause of the ever-increasing level of tax evasion [54]. Richardson [61] similarly examined the relationship, between fairness and tax evasion. He found the relationship to be inverse which implies that the higher the level of fairness, the lower the tax evasion level.

Most of the prior studies indicated a negative relationship between perceived fairness and tax evasion when the perceived fairness is high, signifying higher compliance attitudes [13,47,51,59,62]. Contrarily, few studies revealed an insignificant impact of fairness on tax evasion [63,64,65]. Based on the above exposition regarding tax fairness-tax evasion relationship, this study proposes the following hypothesis.

H2: There is a negative relationship between Tax Fairness and Tax Evasion.

III. ETHICS AND TAX EVASION

Ethics refer to a moral attitude which guides human actions including business activities, and it forms a part of attitude about people's behaviour [66]. Ethics involve a compliance with moral rules and values in human activities [67]; it is a set of concepts and principles that guides us in determining what behavior helps or harms sentient creatures. Thus, tax ethics, tax morale, or tax honesty are described as an intrinsic motivation to pay taxes emanating from the ethics obligation to pay taxes and the belief in meaningfully contributing to the society by paying taxes [68,69,70].

In other words, ethics are systems of behavioural principles designed to provide orientation in social interactions, or the relationship between the behavior of people and are applied to adjust and temperate the human affairs [71]. According to Hogan [72], five dimensions can be used in explaining ethics works. This comprises knowledge, socialization, autonomy, empathy, and ethical judgment. Richardson [61], in his study across 45 countries, revealed that non-economic factors have the most substantial influence on tax evasion when compared with the economic factor. He also found ethics as one of the essential factors. Considering the ethics feelings like guilt and shame would give a suitable clarification about the compliance behavior of taxpayer [73]. Guilt feelings, also known as tax ethics, can lead to a tax evasion reduction [74].

But ethics values are regarded as a societal phenomenon which is hard to explain [75]. Tax evasion is unethical and it affects the distribution of wealth (public benefits financed by tax revenues) among the society at large as another stakeholder is affected by such act [76]. Meanwhile, empirical evidence suggests that the level of belief in the importance of ethics and social responsibility can directly influence the ethical decision processes [76]. Individual norms are related to moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency, and values [34]. There is a considerable overlap between individual norms, values, and tax ethics; when the moral reasoning or tax ethics are more developed, the voluntary compliance will more likely take place [34].

Ethicality of tax evasion can be categorized either as fully unethical, fully ethical or in between them depending on the cases [77]. Tax evasion is seen as unethical since taxpayers have a duty to pay taxes to their country. From the Islamic perspective, a tax evasion is an unethical act that attracts serious penalties [33]. The effect of tax evasion is not only harmful to the economy, but it also derailed from its purpose in helping the poor as enshrine in Islam. Taxpayers' ethics play a potentially important role in their (unobserved) compliance decisions [32]. Compliance would be higher if a moral appeal to taxpayer is made by the government, that the low social standing of tax evaders

can be an effective deterrent that taxpayers with tax evaders as others are more likely to be evaders themselves, and that compliance is greater in communities with a stronger sense of social cohesion [69].

In the same manner, a negative relationship is found between tax moral principles and tax evasion by Riahi-Belkaoui [24]. Therefore, consideration must be given to the ethics of the taxpayers when investigating the tax evasion behavior. On the other hand, Blumenthal et al. [78] argued that the tendency of taxpayers with tax ethics towards tax evasion is higher. Meanwhile, some other researchers [79,80] reported that ethical persuasion has no decreasing impact on the tax evasion. Contrarily, tax ethical is found to have a positive association with tax evasion by [81]. However, caution has to be made as ethical concern itself does not necessarily eliminate tax evasion [82,83].

Though most of the earlier literature indicated a negative relationship between tax ethics and tax evasion [6,24,32,34,69,84], other studies found the relationship between them are either positive or no relationship [79,80,81]. Thus, the following proposition is made.

H3: *There is a negative relationship between ethics and tax evasion.*

IV. PEER INFLUENCE AND TAX EVASION

The concept of ‘peer’ is generally defined as the taxpayer’s associates which can be friends, relatives, colleagues, and co-workers [30]. The influence of peer groups is high, and it has a strong impact on the taxpayers’ preferences, personal values and behaviour [85]. Respondents with peers influenced in unlawful activities are more likely to be non-compliant [59]. Peer influence forms a part of the cultural characteristics of specific groups of individuals or nations [68,86].

In the context of taxation, taxpayers’ compliance behavior is influenced by the tax behaviors of others [7]. Therefore, the tendency of the taxpayers to file a tax return is likely going to be high when they hold the belief that other taxpayers are also disclosing their taxes. Hence, the decision making of taxpayers may be influenced by individuals or groups like family, peers, friends and co-workers [87]. According to Scholze et al. [86], the other people’s opinion is the essential factor influencing the change in taxpayers’ commitment to comply. If the taxpayers believe that tax evasion is common and widespread among their referent groups, their tendency to be non-compliant is as well very high [34].

Hence, the implication is that if many taxpayers are in the act of evading taxes, other taxpayers see it as a greater incentive and motivation to evade taxes too. However, where a significant number of others disapprove tax evasion act, the tendency of taxpayers to engage in the act of tax evasion is less. As stated by Alm et al. [7], the behaviours of the taxpayers are influenced by their “neighbours” behaviour, or the people about whom they may know or have information, or with whom they are interacting with regularly. Taxpayers appear more possibly to be compliant when they believe that other taxpayers comply; but when they believe that others engage in tax evasion, they may as well engage in it. The greater the society’s social norm of compliance is, the greater the guilt that is felt by a taxpayer who cheats on his or her tax liability will be. In a society where there is a stronger sense of social cohesion, the compliance level will be high in such society [40].

Sutinen and Kuperan[88] described peers' opinions and the extent of social influence a taxpayer encounters in socialization as the key variables determining compliance. Social influence is concerned with how our thoughts, feelings, and behavior change in the presence of others [89]. That is to say, social norms and conformity are a powerful force shaping behavior in any social context. Additionally, corruption can spread as a reflection of the social norms that govern in-group relationships [90]. Thus, taxpayer's beliefs about others' compliance behavior shape the compliance decision. These taxpayers are less likely to cheat on their taxes if others behave honestly [69,91].

Therefore, a better perception of the compliance level of other members of the society could reduce the magnitude of tax evasion [92] and vice-versa. The examples given by their peers indeed motivate many decisions taken by taxpayers. Similarly, their behaviour towards tax is dependent on the compliance of other people in society which is influenced by social norms [93,94]. [86] revealed that the opinion of others influences taxpayers' commitment to tax evasion. Similar findings are documented by other studies [82,95].

Some more recent studies also revealed a significant influence of peer influence on tax reporting decision [6,7]. However, the insignificant impact of peer influence on tax evasion has also been reported, particularly more than two decades ago [96,97] and in a recent study by [98]. Hite [96] investigated the effect of peer influence with the aid of experimental approach, while Hanno and Violette [97] measured the beliefs of taxpayers about particular referent groups comprising friends, family members, spouse, and employers. A recent study by [98] reported that the family and friends compliance did not bring about the increase in the level of compliance.

In short, the above review indicated that most of the previous studies documented a significant and a negative effect of peer influence on tax evasion [3,6,7,31,34,86,87,92,99], whereas only few studies reported an insignificant effect [96,97,98]. Consequently, the following hypothesis is derived.

H4: *There is a negative relationship between peer influence and tax evasion.*

III. PROPOSED RESEARCH FRAMEWORK

The proposed model, as shown in Figure 1 below, is developed based on the social influence theory, suggesting that the perceived corruption, fairness, ethics, and peer influence affect tax evasion behavior. The Social Influence Theory refers to the individual's emotions, opinions, or behaviours when affected by others [99]. The theory of social influence is related to social learning theory, which is attributed to [100] idea that the person is affected by the surrounding environment. In other words, the theory of social influence claims that others intentionally or unintentionally influence the individual's behaviour in the environment, and such behaviour is explained by the relationship of the continuous common interaction between cognitive and behavioural environmental influences. Moreover, the outcomes of the behaviour play a significant role in influencing the attitudes of people [100]. Crisp and Turner [89] suggested that social influence is concerned with how our thoughts, feelings and behaviour change when in the presence of others.

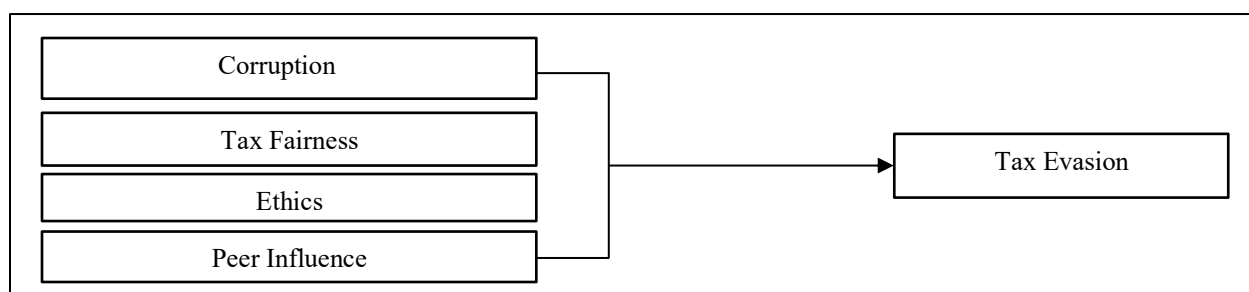


Figure 1: Conceptual Model for Tax Evasion

Social influence is a broad term that relates to many different phenomena. It is linked to conformity, obedience, and compliance. Conformity is a type of social influence involving a change in behaviour, belief or thinking to align with those of others or to align with normative standards. It is the most common and pervasive form of social influence [101]. Obedience is a form of social influence that is derived from an authority figure. According to Frager [102], it is evidenced that humans behave surprisingly obedient in the presence of perceived legitimate authority figures. With regards to tax evasion, the critical determinant of compliance is the views of peers as well as the degree to which the social influence the taxpayer comes across in the socialization process [88]. Compliance is a function of the perceived power of a person at his disposal and the persuasive tactics that other persons employed in getting his consent. Hence, power in action means influence. In essence, power is the ability or capacity of an institution or person to wield influence [103].

IV. CONCLUSION

Tax evasion is a universal phenomenon that takes place in all societies. Many factors have been adduced to cause tax evasion, but four behavioral factors, namely corruption, tax fairness, ethics, and peer influence have been considered as a major determinant of tax evasion from social influence perspective. Prior studies examining the influence of corruption, fairness, ethics, and peer influence on tax evasion in the Middle East region is extremely limited. Hence, this conceptual paper proposed a model, entailing corruption, tax fairness, ethics, and peer influence as predictors of tax evasion in the Palestinians' context. This conceptual framework presents a detailed insight into tax researchers and tax authorities, in particular, to understand further how corruption, tax fairness, ethics and, peer influence lead to tax evasion. The outcome of this proposed model is expected to provide useful input to the tax authority in addressing the tax evasion problem, specifically in the Palestine context, and broadly can be considered to other Middle East countries as well. Due to the dynamic nature of tax evasion, there would always be a need for continuous research on this area over time. Line with above all business and economy courses must integrated responsibility instilling tax paying citizenship.

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