



ORIGINAL PAPER

A Basic Necessity of a Modern Fiscal Policy: Voluntary Compliance

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Abstract

Paying taxes can be considered a contribution to the welfare of a society. Taxpayers should perceive the exchange between tax payments and provision of public goods and services as higher. Taxpayers' willingness to cooperate with the state and its institutions in general, and their willingness to pay taxes in particular, depend on a variety of variables. While researchers in the field of taxation highlights the relevance of external variables such as tax rate, income and probability of audits and severity of fines, psychological research shows that internal variables are of similar importance. In this article we present a view on the relevance of citizens' knowledge of tax law, their attitudes towards the government and taxation, fiscal language, level of tax education, as well as motivational tendencies to comply.

Keywords: *taxation; taxpayer behaviour; tax education; tax compliance; fiscal language; social influences*

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Introduction

An efficient state is able to mobilize revenue and spend it in a manner that stimulates both human capital and community welfare, as well as private investment and creation of new jobs. Also, an efficient state manages the public financial resources to ensure a stable macroeconomic balance: with neither too restrictive policies that discourage private investment and economic growth, nor too adjustable (flexible) to generate high inflation rates or crowding-out effects (expansive effect of government expenditure growth on total aggregate demand is severely mitigated when investment and acquisition of durable goods are funded by resorting to the monetary-financial market).

The impact of fiscal policy on the economy is complex and profound. In this regard, the accumulation of productive factors by investing in physical (infrastructure), human (education, health) and technological capital (research-development and innovation); ensuring a stable macroeconomic environment in which 'healthy' public finance contributes to economic stability and support monetary policy in maintaining price stability; adequate incentives through the tax system and tax benefits for the positive influence of labour, saving and investment decisions are just some of the real ways to boost economic growth. It can be noticed that, more and more frequently, a wider range of tax issues lie at the heart of the sustainable development process.

Countries with efficient institutions may be more effective at deterring tax non-compliance attitude (Andrighetto et al., 2016). Failure, whether it is taxation, budgetary expenditure or management of the budget deficit and of the public debt, may quickly undermine the economic growth of a state. Tax weaknesses can be, in this regard, fatal for business environment and social peace: when one or more professional, ethnic, religious, gender, regional, etc. groups are taxed inequitably (Hartner et al., 2008; Hofmann, Hoelzl, Kirchler, 2008; Torgler, Valev, 2010; Ross, McGee, 2011; Strielkowski, Čábelková, 2015) or are subject to an inequitable allocation of the public expenditure (Barone, Mocetti, 2009; Walsh, 2012).

The propensity to tax evasion is born out of a game of interest that is often only a form of selfishness and human cupidity. When tax burdens push too hard or unclear on a taxable object, it tends to evade. It is a category of 'economic reflex' that makes the capital that the fiscal body imposes too much to disappear. Excessive taxation puts taxable object on the run (Drosu-Şaguna, 2013). On the other hand, a modern tax administration that relies on efficient public institutions can encourage voluntary compliance of citizens to the extent that they feel they are receiving something (high quality public services) in exchange for their money (Levi, 1989; Smith, Stalans, 1991; Edlund, 1999; Frey, Torgler, 2007; Cummings et al., 2009).

In this context, it is extremely important for the taxpayer to understand its tax liabilities, to realize the importance of correct declaration and full and timely payment of due taxes so that the state can, in turn, provide citizens with quality services timely. In relation to fiscality, taxpayers' attitudes may be defined as positive or negative views of tax compliance behaviour. The outcome of positive views is tax voluntary compliance and negative views are tax non-compliance.

Voluntary compliance is the most effective and easy attitude through which budgetary revenue can be collected, being the process by which taxpayers, natural and legal persons, declare voluntarily and pay in full and on time their tax liabilities. This is a hypothesis according to which taxpayers will strictly adhere to tax laws and, more importantly, will honestly report revenues and other taxable objects and an all-time

desideratum of all public administrations (Simon, Clinton, 2002). Therefore, voluntary compliance in taxation has a broader meaning, it covers filing compliance (filing returns on time), reporting compliance (reporting incomes correctly) and payment compliance (paying tax due on time) (Walsh, 2012).

Today there is a general consensus that the basic strategic objective of a modern tax administration (implicitly, of a modern fiscal policy) is to raise the levels of voluntary compliance by taxpayers through two main lines of action: service facilitation and simplification for those who want to comply voluntarily with tax liabilities on the one hand and, on the other, a radical fight against tax evasion (Mitú, Stanciu, 2018). These two lines of action are fully complementary, because the major objective of a modern tax policy should not be centered on finding the tax fraud but rather on its reduction. The fraud discovery in the tax area is extremely important, but a modern public administration needs to focus on prevention, and therefore needs to think more 'ex ante' and less 'ex post'.

Deeper understanding of taxpayers' behaviour can determine tax administrations to develop efficient and more serious compliance risk treatments (Walsh, 2012). For a long time, the tax compliance has been attributed to fiscal policies that are based on punishment, such as the use of tax punishment instruments like tax audit, fines or other penalties (Allingham, Sandmo, 1972; Alm, McClelland, Schulze, 1992; Weber, 1992; Brockmann, Genschel, Seelkopf, 2016). The attempt to explain the taxpayers' behaviour, centered on threats and discouragements, was unable to offer a realistic, comprehensible and comprehensive imagine of tax compliance. Simply management of traditional factors of tax compliance are an expensive way to attempt to improve compliance. Therefore, many researchers have introduced in the equation of explaining the tax compliance and non-compliance behaviour of the taxpayers, in addition to economic, classical factors (factors related more broadly associated with economic conditions: the level of actual income, tax rate, tax benefits, tax audit, audit probabilities, fines and penalties) (Bărbuță-Mișu, 2011) and a number of non-economic factors (Lillemets, 2010; Loo, Evans, McKerchar, 2012). The latter, also called socio-psychological factors, were taken into account to explain the behaviour of tax compliance from a deeper and more realistic perspective, thus forming a modern fiscal policy, centered on the typology and needs of the citizen. In the category of non-economic factors, we can include, for example, public education, tax morale etc. (Hyun, 2005). Likewise, Lisi (2015) and Shafiq (2015) suggest that moral and ethical factors are more dominant factors that contribute to tax compliance attitude among taxpayers.

Therefore, in the following, we shall try to outline some non-economic factors (personal and social norms) of voluntary compliance that can provide a modern dimension of tax policy promoted by public administrations.

Preconditions for a modern fiscal policy: analysis of some socio-psychological factors of voluntary compliance

A society infested with the phenomenon of tax evasion (tax non-compliance) is condemned to economic, social and political devolution. The degree to which citizens engage in fiscal non-compliance actions differs quite widely from one state to another (Schneider, Enste, 2013). However, there are a number of socio-psychological factors that influence more or less the attitude of tax compliance or non-compliance.

Attitudes toward taxes. Improving tax compliance requires long-term reform efforts. Modern tax administrations need to become aware that high-quality services are encouraging compliance (Le Baube, 1992) and reduce taxpayers' costs (Araki, Claus,

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2014). They need to focus on simplifying the performed operations and implementing robust collection systems (e.g., payment and withholding systems). Reform of the legal framework and judiciary is also often required to ensure that the necessary powers, penalty regimes, and dispute resolution processes are in place. If tax rules and restrictions are well written, understandable, and relevant to a taxpayer, they will voluntarily comply and follow the procedures, rules, etc. because they understand and see their value and necessity (Silvani, 1992; Russell, 2010). Taxpayers' attitude to tax rules depends very much on how they understand them, perceive them as being or not being accessible to them in knowledge, interpretation and application.

While values (personal, social and national norms) represent beliefs that influence behaviour across all situations, attitudes relate only to behaviour directly towards specific objects, process, or situations and are a learned predisposition to respond in a consistently favourable or unfavourable manner (Fishbein, Ajzen, 1975).

Fiscal Psychology Theory explains that the taxpayer's perception of the fiscal policy is an important factor. Increasingly more often, Fiscal Psychology Theory emphasizes the loss of motivation of the taxpayer to pay taxes because there is no real and obvious advantage of the benefits of tax payments (Hasseldine, Bebbington, 1991).

In order for the taxpayer's attitude towards the tax system to be positive, the used tax laws and language should be very clear and well calibrated.

The many obligations that tax laws impose on taxpayers, the burden of these obligations and legislative instability have in all phases stimulated the ingenuity of taxpayers to invent various tax evasion processes (tax non-compliance).

The lack of tax compliance is a logical result of the defects and inadvertence of a legislation with a high degree of imperfection and badly assimilated, of the defective methods and modalities of implementation, as well as the lack of vision and the incompetence of the legislator to develop clear normative acts.

In Romania, the study titled 'Increasing Integrity in the National Agency for Fiscal Administration through Institutional Co-operation and Capacity Building' (April, 2016) identifies among the main vulnerabilities of the tax system, the unstable, cumbersome and often incoherent tax legislation (containing unclear provisions or even contradictory). The vulnerability has been identified by all target groups: citizens, economic agents and tax and customs officials.

The need for a solid and rigorous legislative framework in Romania is underlined by the results of the study in 2016 conducted by EY (Ernst & Young) Romania in association with Raiffeisen Bank, entitled 'The Romanian Entrepreneurship Barometer'. In this study, 70% of respondents ranked among the biggest problems of the tax system, the increased instability of the legislative framework. Among the measures that could have the greatest impact in supporting entrepreneurs in the short term (and implicitly, in increasing the degree of voluntary compliance), the second place as relevance (15% of respondents) was occupied by 'creating a clear, effective and simplified legislative framework'. The simplification of tax rules and regulations regarding the calculation of tax liabilities would have a greater impact on improving the fiscal environment in Romania than a reduction in taxes.

Thus, it becomes obvious that Romania needs an immediate stabilization of the tax normative framework and a decrease in the degree of tax complexity that will cause a greater number of taxpayers, placed on an asymmetric level of information and understanding degree, to adopt an attitude prone to voluntary tax compliance.

A good attitude towards tax is closely linked to the use of a fair and appropriate 'fiscal language' for both interpreting and implementing the tax legislation. *Fiscal language* expresses much more than simple words, notions, concepts and expressions, it expresses how taxpayers are in relation to tax liabilities, how they interpret and apply tax legislation. This specific language must be used so that the legal provisions that make use of it are understood, believed, heard and met.

In other words, taxpayers use fiscal language to understand correctly and fully tax legislation and, as a consequence, to know their payment obligations to the state. Therefore, fiscal language is a tool of daily communication, knowledge and compliance for taxpayers, and power for tax authorities and government.

The tax authority also comes from the power of seduction and understanding of the fiscal language used. It should be used so as to constitute both a way in which the legislator can enable taxpayers to comply voluntarily and a 'power attribute'.

Tax education is a crucial element for having an appropriate, easy to understand language and clear tax legislation, without gaps leading to voluntary compliance behaviour.

Supporting the previous research made by Witte and Woodbury (1985), Beron, Tauchen and Witte (1992) found a positive connection between tax compliance and education level. Mohani (2001), has found that voluntary compliance is directly proportional to the level of professional qualifications. Higher qualified taxpayers have more abilities and greater confidence in managing tax issues. This view is supported by Eriksen and Fallan (1996); Chan, Troutman and O'Bryan (2000), and also Richardson (2008), who identified a positive association between voluntary tax compliance and education. A taxpayer with a high level of education and a better understanding of the tax mechanism should realize how important tax revenues are for the development of the society it is part of. Therefore, it will be more aware of its responsibility towards the country and, at the same time, will be sufficiently informed to understand the repercussions and sanctions imposed if it violates the legal tax framework.

However, there is a limit of this education level effectiveness in which a curvilinear effect has discovered. It means at the certain level, additional knowledge and education will not proportionately decrease the intention by the taxpayers to voluntary comply (Hassan, Nawawi, Salin, 2016). Likewise, Collins, Milliron and Toy (1992) find that the tax knowledge is not significantly correlated with tax voluntary compliance behaviour.

Like Wong and Lo (2015), our opinion is that these divergent conclusions may be explained by '*an inadequate understanding of tax education and its impacts on changing individual tax voluntary compliance behaviours.*'

In Romania, the level of financial education (and, implicitly, tax education) is worrying, with citizens lacking basic knowledge of the financial notions and concepts needed to make decisions tailored to their needs. Awareness of the real level of financial education of the population is the first step in finding solutions tailored to different social categories (Behrman et al., 2012; Lusardi, de Bassa Scheresberg, 2013; Lusardi, Mitchell, 2014; Lusardi, Tufano, 2015).

Biriş (former Secretary of State in the Ministry of Public Finance), an important tax specialist, referring to the tax education in Romania, made the following statement:

Romania needs a coherent program of tax education, both in schools and in the media or through the distribution of educational materials [...] it is necessary to

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create taxation faculties to prepare both tax advisers and future heads of tax authorities and judges specialized in tax disputes (Biriş, 2012, pp. 231-232)

According to the S & P Global Finlit Survey (2014) study, developed by Standard and Poor's Ratings, which was conducted on a sample of 150,000 people in 143 countries, Romania ranks 124 out of 143 in a global financial education ranking. Only 22% (1 out of 5) of Romanians have adequate financial education. In the EU, Romania is in the last position of financial education. Worldwide, only 1 out of 3 people have financial education, Romania being below this average. *'The main source of financial education for the young people in Romania is the family, in 95% proportion, while the school has a percentage of 9% and the banks only 5%'* according to the Erste study: What do the Romanians spend the money on and why do they save (2015).

Comparative treatment, when it comes to the issue of taxpayer - tax liabilities relation, is a concept based on the theory of equity and takes into account that the alleviation of inequalities in the exchange relationship between government and taxpayers would lead to an improvement in voluntary compliance (McKerchar, Evans, 2009).

In the field of tax policies, the comparative approach has both a vertical (taxpayers - government) and a horizontal (taxpayer - taxpayer) dimension. There is social contract between government (ruler) and taxpayers (ruled) which embodied effective delivery of political goods (Besancon, 2003). Levi (1988), analysing the correlations between taxpayers and government, notes that voluntary compliance is influenced by the vertical contract. He notes that there is a direct link between the magnitude of the rate of transformation from tax to political goods and the degree of citizens' satisfaction. If this rate is low, the taxpayers will believe that the government has not maintained the contractual commitment, consequently, voluntary tax compliance will worsen. Often, the understanding of how taxpayers' money is being utilized becomes very subjective; the fact that they do not receive a fair share of government benefits or others do not meet their obligations are considered as possible factors influencing tax compliance behaviour (Ho, Loo, Lim, 2006).

Neither citizens nor the state can stand outside of the fiscal game. These are not actors who can maintain their neutrality from fiscal policy. In this relationship, they influence and interrelate mutually (Ali, Fjeldstad, Sjursen, 2013). Generally, taxpayers do not think of their fellow citizens without considering their own relationship with the state. Building relationships between civic engagement and citizen participation is vital (Olimid, 2014). As such, the tax behaviour of a citizen is influenced by its own relationship with the state, but also by the way the state is related to its citizens. If the state treats preferentially certain groups, it will influence the citizen's relationship with the state and the group receiving favours (D'Arcy, 2011). In this context, it is very important not only the fiscal treatment that a citizen benefits from the state but also the treatment applied by the state to the taxpayer in question compared to other persons in a similar situation.

An illustrative example of unequal tax treatment in similar situations is given by the inequality created in Romania by the differential approach of the tax burden on taxpayers who obtain similar income but have different forms of organization.

Thus, as of January 2018, the tax burden on an employee is much higher compared to a taxpayer who is organized as PFA (authorized physical person) or through a micro-enterprise. Wage labour implies a high degree of taxation, about 45% (35% social security + 10% income tax), while in the case of a micro-enterprise, we are dealing with

a much lower taxing rate, of 6% (1% turnover tax, if there are employees + 5% dividend tax).

Even if the tax gap is not so great between wage labour and PFA, and there are differences to consider in favour of PFAs and other people who earn income from self-employment, including copyright. Specifically, the latter pay social contributions at the level of a gross national minimum salary (at the time of writing this article: 1900 lei), no matter how much they earn in a calendar month. For example, an employee with a gross salary of 5,000 lei/ month now has the same tax burden (income tax and individual social contributions) as a person who earns an income from independent activities of over 14,000 lei, i.e. three times more. Thus, liberal professions are favoured because the tax burden is lower. An unhealthy status quo is created: the more you earn the less taxes you pay. As a result of the significant differentiation in terms of tax treatment, between wage labour and activity carried out by authorized physical person (PFA), it is adversely affected the concept of voluntary compliance with implications for good governance because a large part of the taxpayers will feel unjustified, generating dissatisfaction and social imbalance. Such a differential treatment destroys the balance, almost fragile, among all those involved in this issue, the balance between citizens and the balance between citizens and the state (government). Torgler (2003) argues that when government's honesty is down, tax compliance may be disrupted, in a negative sense, because government fails to honour his honesty.

Comparative treatment is a causal mechanism in the debate on good governance and sustainable economic development. Rothstein and Teorell (2008) believe that impartiality in the exercise of power is a determining characteristic of a 'good governance'. The state's legitimacy rests on its impartiality; it's proven ability to treat citizens equally in its dealings with them (D'Arcy, 2011).

Social influences (social contagion). Because human beings are social and learn from observation rather than depending entirely on instinct, almost all aspects of human psychology and behaviour are socially influenced. Snaively (1990), referring to tax behaviour, notes that it is subjected to strong disruptive factors, such as the influence that the social environment generates, the behaviour of an individual's reference group such as relatives, neighbours, friends, public figures etc. (the horizontal dimension of behaviour). Therefore, if a taxpayer knows more individuals who are part of significant human groups for itself, who evade tax liabilities, its own desire to comply will be weaker. Perception of the honesty of others can affect voluntary compliance (Sah 199; Banerjee 1992). The likelihood that a person will make a decision depends on how many others have already done it (Hedström, Ibarra, 2010). According to Torgler (2008), the social interactions are one of the most underexplored issues in the field of tax compliance individuals. Likewise, he notes that who have tax evaders as peers or friends in their personal circle are more likely to evade themselves.

To know is to prevent. Unfortunately, there are no studies in Romania that determine or quantify the degree of social influence in the field of taxation. However, it is easy to see that citizens have an approximate idea of the level of tax compliance at the level of country, region, social category or economic sector. The image that each citizen creates is derived from information received through the media, personal interactions, or direct comparisons (for example, behaviour, lifestyle, and wealth may be deduction elements in the tax payments by friends, neighbours or people we interact with) (Alm, Gómez, 2008; Gino, Ayal, Ariedly 2009; Diekmann, Przepiorka, Rauhut, 2015).

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Acquiring a certain behaviour through contagion (rational or non-rational imitation) can have both negative and positive effects. In the field of taxation, the balance can be tilted to positive (voluntary compliance) or negative (non-compliance) depending also on the examples that public administration as well as society as a whole give them about combating and condemning evasion. Learning through contagion can lead to negative, deviant behaviours, but people can also learn from their colleagues' failures or suboptimal choices of how not to behave (how to have a positive attitude).

In Romania, social influence has a rather negative connotation. The impossibility of the tax authorities, often too obvious, to discover tax evasion by some taxpayers, the application of some mild punishments in some cases, disproportionate to the gravity of the facts, excessive mediatisation and with positive connotations of those who managed to trick the system, creates an environment in which those who do not obey the legal framework are advantaged towards those who comply with it, with extremely negative effects on voluntary compliance attitude. The discredit of public power in front of taxpayers, the use of power in cases of tax evasion, inevitably leads to an increase in the number of tax evaders, and the impossibility of controlling the phenomenon.

Conclusions

The need to reconcile the interests of the two parties involved in the tax mechanism, on the one hand, the taxpayers (natural and legal persons) and on the other side the state, requires a profound research of the levers and phenomena that influence its proper functioning. Highlighting and analysing factors with an impact on voluntary compliance offer a possible way to do so, even though literature has made a major step forward in the past few years, it requires more in-depth and longer-term research to fully understand the complex relationship that is created between citizens and the state.

Public governance quality influences tax compliance. Where there is public governance high quality, the tax system should to be good, these being in a very close interdependence (Everest-Phillip, Sandall, 2009). Fiscal policy may have either positive or negative influence on the tax compliance behaviour. Therefore, the behaviour of taxpayers may be affected by public governance either positively or negatively. Improving the balance in the relationship between taxpayers on the one hand and tax authorities on the other hand is the basis for increasing taxpayers' confidence in the tax system and tax policy promoted by it.

It is extremely important for the taxpayer to understand its tax burden and liabilities, to become aware of the importance of voluntary compliance so that the state can, in turn, provide citizens with quality services and ensure that all taxpayers are treated properly and equal. Taxpayers choosing to comply voluntarily realize that taxes are the price we pay to have a modern and prosperous society.

Voluntary tax compliance is based on a very complex mechanism. The factors that determine and reinforce it are, as it has already been well outlined in the literature, both economic and non-economic.

The main driver of voluntary compliance is the taxpayer's perception (Kiow, Salleh, Kassim, 2017). In the absence of complex connections with non-economic factors of influence, the phenomenon of voluntary compliance cannot be fully understood. Individual mindset on dealing with issues like tax policy, constitutes the socio-psychological determinant of tax compliance behaviour. Thus, socio-psychological perception plays an important role for taxpayers to properly fulfill their tax obligations.

Tax revenue collection is an art in which voluntary compliance occupies a fundamental place. The success of this approach depends on the degree of involvement and understanding of the phenomenon by both sides (taxpayers and state). That is why, along with Kirchler, Kogler and Muehlbacher (2014), we believe that the approach of the Dutch Tax and Customs Administration - 'horizontal monitoring', which is based on the firm belief that a positive relationship based on mutual trust between taxpayers, tax practitioners and tax authorities, reduces unnecessary supervisory costs and burdens, complex discussions about tax designs on the edge of legality, and aggressive tax planning with retrospective adjustments. This pioneering approach to tax policy, introduced in 2005, proposes horizontal monitoring as an alternative to the classical vertical monitoring (Committee Horizontal Monitoring Tax and Customs Administration, 2012). Therefore, we believe that at the moment, the attitude towards tax, fiscal language, tax education, comparative treatment, etc. are factors that are becoming more and more important in the deep understanding of the mechanism that determines the attitude of voluntary compliance.

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Article Info

Received: March 19 2018

Accepted: April 02 2018

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