Soliciting the Antecedents of Tax Ethics: An Indian Perspective

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Abstract

Tax compliance constitutes an important aspect of a government's efforts at socio-economic management to ensure public welfare, equity, and development of the state. Driven by the shortage of financial resources, states–especially developing countries–have started to view tax compliance as a serious matter. This study is an attempt to analyze the dynamics of tax morale among the Indian taxpayers and to develop a well-structured scale to measure tax morale among the taxpayers. Survey data collected from a sample of four hundred and fifteen individual respondents produced a multi-factoral solution explaining sixty nine percent variation in the factor structure. The psychometric properties of the five-factor-structure scale–fiscal exchange, conditional cooperation, social capital, institutional dynamics, and financial satisfaction have been established through confirmatory factor analysis. The postulated survey instrument intends to provide new insights on and implications of the tax compliance problem.

Keywords: *Tax compliance, Tax ethics, Taxpayers' morale, Tax gap.*

Introduction

A glimpse into history reveals that taxes are as old as the existence of ancient civilizations themselves (Mitra, 2011). An example of ancient text that refers to taxes is *Shrimad Baghwata Gita*, which is an ancient Sanskrit scripture that is part of the Hindu epic entitled *Mahabhaarata.* The said text refers to it as *Kara*. On the other hand, Kautilya's *Arthashastra*, which is an ancient Indian treatise on statecraft, economics, military policy and strategy that dates back to the third century B.C., enumerates how kings needed to levy and collect taxes for the safety and development of the state. However, the compliance of tax laws and regulations has been an achilles heel for governments around the world. The history of evasion of taxes also dates as long back as the existence of taxes themselves. Long ago, the United Nations Expert Group on Tax Reform Planning (The Direct Taxes Enquiry Committee Report, 1971), therefore, observed that "tax evasion is not only an effect of the pressure that tax rates alone cause, it is also a matter of attitude among the taxpayers' community".

This study is an attempt to work towards identifying such factors that may address stimulating tax compliance behavior among the individual taxpayers in India. The reasons

behind tax compliance attitude could not be properly established in the absence of a composite enabling framework. The relationship dynamics between the state and its subjects and, more specifically, the relevance of the existence of state and its governing institutions, in a contemporary setting, is what needs to be revisited.

Background Literature

Empirical research suggests that tax payment attitudes have been found to vary across different situations and perspectives. However, what remains a mystery are the possible determinants behind such varying behavioral tendencies. Such variation of tax attitude is justified across differing fields–from an economic perspective to a behavioral, psychological, or social perspective. Torgler & Schaltegger (2005) maintains that implementing universal tax compliance is virtually impossible "until there is a tax administrator under every bed". Related literature suggests a host of tax compliance models with emphasis on compliance behavior in terms of economic as well as behavioral perspectives. The economic models emphasize aspects of tax compliance in terms of a cost-benefit decision analysis, which it gathers from data on the function of penalties and audit rates vis-a-vis successful tax evasion. The classical model given by Allingham and Sandmo (1972) rests on Becker's (1968) model of economic crimes being applied in the taxation context.

The classical model holds that tax compliance behavior of an individual is a function of four important determinants–probabilities of detection (audit), penalty rate (fines), tax rate, and income base. The economic modeling approach, hence, perceives compliance as an indicator of four economic determinants only–with deterrence as the underlying stimuli. However, further research has observed the inability of this 'portfolio approach' to explain the all-inclusive dynamics of compliance behavior in practice. Further, as Dean, Keenan and Kenney (1980) hold: "to abandon taxation studies to arid suppositions concerning how taxpayers might act if they were condemned to being entirely rational, utility-maximizing automatons can only serve to postpone the emergence of realistic tax theories and useful policy insights". Moreover, a host of empirical studies have noticed taxpayers to be honest in practice vis-à-vis the common perception, which is based on the standard economic framework, that they are not so truthful. The research has noticed that, while there are certain individuals who tend to behave honestly despite so many opportunities to escape, others tend to indulge in dishonest behavior–despite the provision of a stringent deterrence framework.

The standard tax compliance models based on economic perspective fails to account for such outcomes. However, by the late eighties, studies like Cowell (1985), Scotchmer & Slemrod (1989), Falkinger & Walther (1991), and Alm, Sanchez, & De Juan (1995) broadened the scope of tax evasion by asserting and bringing the non-economic factors into the study of the tax compliance problem. Instead of simply relying on negative outcomes (deterrence and penalty), positive inducements (like rewards and recognition) were suggested for inducing the level of tax compliance. Hence, modern research efforts started recognizing the relevance of non-economic factors in influencing tax compliance behavior as well.

This development in the study of the tax compliance problem asserts that human element plays a vital role in the individual's tax compliance decision process. A host of theories presenting various models have emerged in the behavioral compliance domain with socio-psychology, political legitimacy, comparative treatment, fiscal exchange, modernization theory, crowding theory, compositional modeling, and equity theory, among others. Although a perusal of literature holds the level of efforts being put in examining the issue of compliance in a holistic manner, states have usually resorted to tackling the menace through either coercive, educative, or economic measures. However, what is being missed is an equally important domain of what defines the relationship between the state and its subjects and how an individual's morality–aside from what the tax law framework put together–define tax compliance intention.

The purpose of this study, therefore, is to bridge the aforementioned fissures in the existing literature with an attempt aimed at gaining better insight into the multidimensionality structure of human tax compliance attitude. For the said purpose, the study has made an attempt to develop a reliable scale that can be administered among tax payers to understand the 'intrinsic motivation or willingness to pay taxes'. The scale will help researchers and practitioners to measure the determinants of tax compliance attitude in a comprehensive manner.

Research Methodology

Scale Development

Mann and Ghuman (2014) outline a four-step process for the development of a scale. This study utilized the framework of the four step-scale development process involving "(1) Item generation, pre-testing, and item refinement; (2) Data collection; (3) Scale purification using exploratory factor analysis (EFA) and confirmatory factor analysis (CFA); and (4) Reliability and validity tests". The process started with developing an initial pool of relevant items based on empirical literature. Further, the relevant items were pre-tested and refined with actual data collection on a pilot basis. The initial scale was then purified using exploratory factor analysis to provide a multivariate outlook on the constituent elements. The EFA was conducted using Varimax rotation and all factors with Eigen values greater than one were taken to obtain the desired factor solution. Next, the scale was examined for reliability and validity concerns using the measure of Cronbach's alpha and convergent, discriminant and content validity (using CFA).

ITEM GENERATION, PRE-TESTING, AND REFINEMENT

Hinkin et al. (1997) asserts that the process of scale development begins with the initial stage of mapping and identifying all relevant constituent items related to the scale. Hence, an initial pool of items comprising forty statements in concurrence with the empirical literature had been prepared.

A combination of both the inductive and deductive approach combined together for item generation has been employed. As a first step, therefore, a classification of the

dynamics of tax compliance was made. Thereafter, the process went into designing a questionnaire to accurately assess compliance attitude. For this, unstructured interviews with tax officials and tax professional service providers (chartered accountants', tax return preparer's) were conducted. The inputs from unstructured interviews, coupled with a review of existing empirical literature, led us to develop an itemized pool of forty (40) statements. The initial pool of forty items was then put to content analysis and validity. "Content validity is concerned with the extent to which a specific set of items reflects a content domain" (de Villis, 1991). Assessment of content validity helps one ensure that the items so generated measure what they actually are thought to measure. Content validity is established using two methods: first, by deriving items after an extensive review of subject literature and second, thorough discussions and cross examination of items by two academic experts in the field. Based on the inputs received, a total of nine items were deleted and certain others were reworded and reframed to bring uniformity to the domain under study.

The items were scaled using a Likert type scale. "Likert scales are the most commonly used in survey research using questionnaires" (Cook et al., 1981; Schmitt and Klimoski, 1991 in Hinkin et al., 1997). "Measures with five- or seven-point scales have been shown to create variance that is necessary for examining the relationships among items and scales and create adequate coefficient alpha (internal consistency) reliability estimates" (Lissitz and Green, 1975 in Hinkin et al., 1997).

The revised sets of items were pre-tested with a pilot survey of fifty respondents spread across the cities of Amritsar, Ludhiana, Gurgaon and Chandigarh. The pilot testing (questionnaire administration) led to removal of three items that were found to be non-uniform, overlapping, and contradictory in the responses. Hence, a total of twenty eight items were being used for the final survey of taxpayers.

DATA COLLECTION

Starting from Rummel (1970) recommending a range of 1:4 as an appropriate item to response proportion, we have a suggested item to response ratio of 1:10 given by Schwab (1980) for data collection for survey instruments. However, recent research advancements have found a sample size of 100 (for CFA) and 150 (for EFA) respondents to be sufficient "as long as item inter-correlations are reasonably strong" (Hinkin et al., 1997).

The present survey concerns data collected from a sample size of six hundred and sixty respondents spread across the major cities of the north-west region of India. The north-west region comprises the states of Haryana, Himachal Pradesh, Jammu & Kashmir, and Punjab along with the union territory of Chandigarh. The survey-sampled cities have been selected in line with the spread of population in the states according to official census statistics, 2011. The list of all cities (population distribution-wise) in a state was prepared in a descending order. From this list, a suitable number of cities was selected for each state with a rider that the cumulative spread across these cities cover at least 25 percent of the states' population. Based on the above rule, twelve cities were selected for sample inclusion and six hundred surveys were supposed to have been administered across these sampled units. However, anticipating the probability of 'no responses', a ten percent-

upward benchmark was fixed, thereby taking the overall sampled respondents to be six hundred and sixty only (Table 1). Each survey aspirant was asked to rate their extent of agreement or disagreement with a statement on a five-point Likert scale response ranging from strongly agree (5) to strongly disagree (1). A total of four hundred and fifteen responses duly filled and complete in all respects were obtained thereby getting the survey response rate to the extent of 63 percent.

Table 1
Sample Distribution for Taxpayers Survey

Based on Spread of Population Statistics			
State	**City**	**Per cent of State's Population**	**Questionnaire**
Punjab (249)	Ludhiana Amritsar Gurdaspur	12.611 21.588 29.872	105 75 69
Haryana (227)	Faridabad Hisar Bhiwani Gurgaon	7.138 14.017 20.464 26.438	61 59 55 52
Himachal Pradesh (62)	Kangra Mandi	21.998 36.562	37 25
Jammu & Kashmir (113)	Jammu Srinagar	12.199 22.061	63 50
Union territory of Chandigarh (9)	Chandigarh	1.43	9

Source: Survey data.

SCALE PURIFICATION

Item evaluation is usually done with the help of statistical techniques–with exploratory or confirmatory factor analysis as the principal tool to accomplish it. The present scale has been refined using the techniques of exploratory factor analysis and confirmatory factor analysis.

Refinement with Exploratory Factor Analysis. Churchill (1979) suggests that "in the absence of a sufficiently detailed theoretical basis, exploratory factor analysis (EFA) is a useful preliminary technique". The principal component analysis has been used with Varimax (orthogonal) rotation for factor analysis of the set of twenty eight survey items. "Component analysis is used when the objective is to summarize most of the original

information (variance) in a minimum number of factors for prediction purposes" (Hair et al., 2010). This study used the Eigen value (Kaiser) criteria for retaining the factors. For selecting the factor loadings, a criterion of a minimum loading value of 0.5 for a variable (to be retained) has been adopted.

The exploratory factor solution for twenty eight items having six factors with 72.47 per cent of variance extracted has been obtained. Two items having low factor loadings (less than the acceptable value of .5) and one item being cross loading on two factors were observed. Subsequently, these three items were dropped and revised factor solution with twenty five items having five factors explaining 69.39 per ent of total variation has been obtained (Appendix I). Cronbach alpha certified to the reliability of the factors with all reliability values being more than acceptable levels of 0.7.

Refinement with Confirmatory Factor Analysis. The application of EFA revealed a five-dimensional construct of tax morale framework (refer to the appendix). For validating the factor structure using CFA, the covariance matrix has been used as the input structure for the measurement model. CFA allows us to test the theory in terms of specification of underlying structure 'a priori'. The CFA has been applied through the AMOS 22.0 software suite. The measurement model was found to be significant and the measures of fitness (goodness as well as badness) were found to be below the prescribed levels. Hence, modification indices (MI) were deployed to closely examine and improve the fitness of the measurement model. Based on MI prescription, three error terms (e2-e5, e8-e9, e11-e14) with high inter-correlation were correlated and the measurement model was re-run with the revised module (see Table 2). The revised solution defined a better overall model fit.

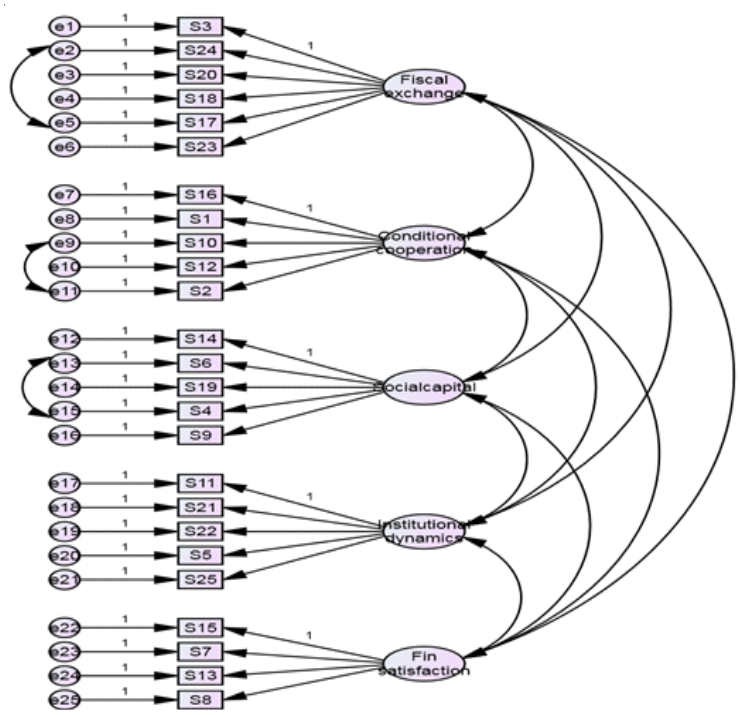
Table 2
CFA Measurement Model

Statistic/Dimension	Tax Morale
Chi-square (CMIN/DF)	2.334
GFI	.851
CFI	.951
IFI	.952
TLI	.944
RMSEA	.057
RMR	.079

ESTABLISHING SCALE RELIABILITY AND VALIDITY

Following the establishment of unidimensionality of the developed scale, the next step concerned the establishment of the internal consistency and validity of the proposed scale. There are numerous measures with exploratory or confirmatory approaches to confirm the reliability and validity in field study research.

Figure 1
Tax Morale Measurement Model



Source: AMOS 22.0

Establishing Reliability. Reliability defines the "measure of the degree to which a set of *indicators* of a *latent construct* is internally consistent in their measurements" (Hair et al., 2010). It is the extent to which the parameters (variables) are consistent with measuring what they are supposed to measure. In simple terms, if multiple observations at different points of time are taken for the same measure, reliable measures would tend to be consistent in the observed values. A measure is considered reliable if it is free from random error. Several reliability measures are available: test-reset, internal consistency (Cronbach's alpha), and alternative forms. We have tested the reliability of the measures using composite reliability (CR) and measure of average variance extracted (AVE).

All the values of coefficient alpha have been observed to be well above the recommended threshold value of 0.7. Moreover, all the composite reliability (CR) statistics are above the prescribed limit of 0.7 and average variance extracted being greater than 0.5 (except one construct), thereby, reaffirming the reliability of the scale so developed.

Scale Validity. After examining the reliability concerns, validity of the scale was recognized. "Construct validity addresses the question of what construct or characteristic is the scale, in fact, measuring." (Malhotra & Dash, 2011). Scale validity was established

Table 3. Psychometric Properties of Scale

	CR	AVE	Institutional dynamics	Fiscal exchange	Conditional cooperation	Social capital	Financial satisfaction
Institutional dynamics	0.849	0.547	0.740				
Fiscal exchange	0.907	0.624	-0.014	0.790			
Conditional cooperation	0.935	0.743	0.036	0.372	0.862		
Social capital	0.839	0.529	-0.032	0.394	0.315	0.727	
Financial Satisfaction	0.822	0.538	0.246	0.103	0.070	-0.007	0.733

Source: AMOS 22.0

using the three prominent measures of construct validity–content validity, convergent validity, and discriminant validity. Content validity has been established during the process of the item generation stage itself by validating the relevance of items in measuring the underlying domain. In addition, expert interviews and content discussion with academic experts helped validate the content specifically. Furthermore, content validity and internal consistency also tended to hint at construct validity of the new scale.

Convergent validity (CV) defines the extent to which construct items tend to converge in measuring the scale domain. The convergence among items is gauged by means of establishing inter-item correlations. The present study established CV with both the exploratory as well as confirmatory factor approach. Setting the factor extraction criteria (eigen value >1) and factor loading significance to be greater than 0.5 ensured convergence among correlated items. Furthermore, setting the minimum factor loading criteria in CFA to be 0.5 further validated the convergence of the scale items effectively. Finally, the values of NFI being greater than 0.85 (*Bentler-Bonett's coefficient*) further validated the convergent validity among the constructs (Bentler and Bonett, 1980).

Discriminant validity (DV) defines the magnitude to which two constructs differ from each other. It ensures that two constructs are free from multicollinearity among the explanatory variables. "A high degree of multicollinearity can cause misleading results in further analyses, like regression, since the standard error of parameter estimates is increased (Peter and Tarpey, 1975). According to the method suggested by Fornell and Larcker (1981), two constructs are said to have discriminant validity if the square root of the average variance extracted (AVE) is larger than the correlation coefficient (phi coefficient) between two constructs" (Mann & Ghuman, 2014). Accordingly, the DV has been established with the square root of AVE being greater than the phi coefficient among constructs. The diagonal values in Table 3 across factors defining square root of AVE are compared against all the other values in that column and rows in the lower part of the diagonal value(s). Thus, the phi coefficient being lower than the Square root of AVE across all factors validates the DV of the constructs.

Conclusion

This study has developed and presents a prudent and comprehensive scale that examines the intrinsic motivation to tax compliance from a taxpayer's perspective. Through a field

survey of four hundred and fifteen individual tax respondents, a twenty five-item Likert type scale has been developed. Furthermore, the psychometric properties of the specified scale have been examined using the measurement model and the reliability and validity measures being established. One common thread binding all such illegal and immoral acts across the universe has been a motivation to disguise the rules laid down by the state. While there has been an over emphasis on economic determinants, other aspects, especially the non-economic dimensions like tax morale, had been traditionally under-represented, the postulated scale reflects the multiple facets of a taxpayer's attitude. Besides the standard economic framework, non-economic factors (tax morale) have been found to provide for a composite structure of taxpayers compliance attitude. The scale intends to make exclusive contribution to the body of literature in at least two different aspects. First, the tax morale dimension, which has been treated as the black box until recently, has been validated as a multifaceted phenomenon. Secondly, the study provides vital inputs for further research on the dimensions of the tax compliance framework in a holistic manner. The morality of the state, in addition to citizens' intrinsic motivation to pay tax honestly and tax law framework concerns, has been upheld as a key aspect by the respondents during the survey exercise. Future research efforts may work upon such gaps to validate the pertinence of the state's morality and its role in influencing taxpayers' compliance attitude effectively.

To sum up everything that has been discussed, the scale intends to contribute to the present body of knowledge on the tax compliance framework and to provide further insights into the tax compliance domain and, probably, the relationship between the state and the subjects in the contemporary settings.

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Appendix
Factor Labels and Constituents Variable

Sr. No.	Factor Level	Constituent Variables	Factor Loadings	
			EFA	CFA
Tax Morale				
1	Fiscal exchange with the state	• Willingness to pay taxes depend largely on how government spends the collected public revenue.	.887	.966
		• Paying more taxes would not change the amount of benefits that I receive from the government.	.867	.794
		• Tax is a compulsory payment to be made to the government by citizens.	.845	.874
		• Public trust in the government affects willingness to pay tax.	.786	.773
		• One should pay less tax if one knows he/she will not get caught.	.780	.648
		• Family members and friends have an influence over tax paying attitude of an individual.	.574	.632
2	Conditional cooperation	• One is less likely to cheat if they find others behaving honestly.	.918	.980
		• Paying tax honestly is the duty of every citizen.	.878	.937
		• There is nothing immoral about cheating on tax.	.875	.819
		• If in doubt whether to report a particular income or not, I would prefer not to report it.	.849	.800
		• One should pay tax honestly even if it does not benefit us.	.819	.752
3	Social capital	• If the tax system is unfair, cheating is justified.	.842	.983
		• Taxes are payment for living in a society.	.823	.650
		• Tax cheating is forbidden as per my religious beliefs.	.803	.862
		• The easily available opportunities to evade tax affect motivation to pay tax honestly.	.757	.494
		• Evasion of tax is against my ethical principles.	.612	.513
4	Institutional dynamics	• There is a intrinsic desire among people to collect wealth secretly from the government.	.899	.899
		• Tax is something that takes away my hard earned money from me.	.862	.861
		• Tax cheating is acceptable if chances of strict punishment are rare.	.852	.853
		• When in doubt, I consult religious teachings to judge what is right/wrong.	.643	.504
		• Since government gets enough money, it does not matter even if few people evade tax.	.591	.451
5	Financial satisfaction	• Tax evasion is justified if tax collected is spent on things that do not benefit me.	.843	.804
		• Willingness to pay tax honestly is affected by a feeling of having less income and wealth as compared to others in the society.	.794	.729
		• People cheat on taxes when they are not satisfied with their financial condition.	.782	.715
		• One cannot carry an occupation successfully by paying all tax dues honestly.	.781	.679