

# Taxpayer Perceptions

Cognitive and social norms  
affect taxpayer attitudes and  
behavior

# Most Analysis Based on the Self-interested “Rational” Taxpayer

- Forms opinions by weighing personal benefits and costs
- Treats a dollar as a dollar
- Objectively measurable tax burdens
- Logic principles such as Aristotle’s principle of non-contradiction apply

# Perception Is Not Always Rational

- Cognitive “bias” often sensitive to context and learning
- Should cognitive bias be considered when designing tax policy?
- “A universal feeling, whether well or ill founded, cannot be safely disregarded.” Abraham Lincoln

# Two Central Questions

- Fiscal Illusion: To what extent do cognitive biases cause “psychic” costs that affect taxpayer attitudes and their responses to taxation apart from the objective burdens imposed?

# Two Central Questions

- To what extent do things other than self-interest, such as “social norms” and “moral reasoning”, affect taxpayers’ attitudes and their responses to taxation?

# Cognitive Bias

- Anchoring
  - People evaluate from reference points
- Possession (Endowment) Effect
  - People value ownership
- Dread/Hope
  - Anticipation has utility/disutility
- Loss Aversion
  - \$ loss more salient than \$ gain

# Cognitive Bias

- Regret Aversion
  - Commission worse than omission
- Salience
  - More emphasis on vivid evidence
- Confirmation bias
  - Discount contradictory evidence
- Framing
  - Order and emphasis of information relevant

# Cognitive Bias

- Reciprocity
  - People go along to get along
- Mental Accounts
  - Money not fungible
- Time Inconsistency of Preference
  - Better next week than now



# Possible Effects of Cognitive Bias

- Replacing a “hidden” tax with a visible tax is perceived as a tax increase
- Tax changes that shift money between “mental accounts” create psychic costs
- People hate negative tax surprises more than they like positive ones

# Possible Effects of Cognitive Bias

- People dislike out-of-pocket taxes more than taxes withheld at source
- Frequent certain tax “installments” cause less resentment than infrequent uncertain payments
- Anticipation of a future tax payment can cause psychic cost

# Possible Effects of Cognitive Bias

- Structures that allow taxpayers to make many errors can cause more regret
- People less resistant to “ear-marked” taxes because they believe there is a reciprocal benefit
- How tax provision is framed can determine attitudes

# Possible Effects of Cognitive Bias

- Familiar taxes cause less resistance than novel/unusual taxes
- People more likely to accept a future tax increase than a current tax increase (for a good purpose)

# Tax Compliance Research Illustrates Same Phenomena

- Compliance depends on “rational” determinants such as cost
- Cost determined by opportunity, probability of detection, and penalties
- Limited rationality—taxpayers may follow heuristic “rules of thumb”
- People show cognitive bias and influence by social norms

# Framing as an Example

- People behave differently in loss and gain positions
  - More likely to evade in loss position
  - More likely to heed aggressive tax advice in loss position
  - View under-withholding as a loss position
  - Frame can be manipulated to improve compliance

# Example: Taxpayer's Moral Beliefs

- Three development levels of moral belief
  1. Punishment avoidance
  2. Social duty/obligation
  3. Principles of justice
- Compliance by level 1 taxpayers most affected by opportunity, probability of detection and punishment

# Example: Taxpayer's Moral Beliefs

- Normative appeals targeted at taxpayers with level 2 can be effective at increasing compliance
- Perceptions of tax system fairness affect taxpayer's perceptions of morality of tax evasion