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Trust as Moderating Variable in the Relationship between Fairness Perceptions and Voluntary Tax Compliance in Nigeria: A Theoretical Framework

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ABSTRACT

This paper presents a theoretical framework on the moderating effect of trust in the relationship between fairness perception and voluntary tax compliance in Nigeria. The variables proposed under examination are fairness perceptions; trust in authority and voluntary tax compliance. If validated the model would have significance important policy implications to the Nigerian government and other stakeholders. The model would also serve as a basis for reference to other researchers willing to undertake study in the same area.

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1. Introduction

This paper presents a theoretical framework on the moderating effect of trust in the relationship between fairness perception and voluntary tax compliance in Nigeria. Several factors have been determined to influence tax compliance in Nigeria such as ethnicity diversity, noncompliance opportunity, governance quality, perceived tax service quality, tax system structures, moral reasoning, tax knowledge, attitudes, risk preference, personal financial condition and demographic variables [3]. Moreover, the model tends to test the perceptions of tax payers on voluntary tax compliance after the amendment of personal income tax act of 2011. The purpose of the amendment is to improve fairness of the personal income tax among taxpayers, the reasons is that Personal Income Tax is also a weapon, which could be used to reduce inequality in society, encourage manufacturing industries, by the use of tax incentives, and discourage undesirable industries [2,5-7,42,45]. However, to the researcher knowledge three studies have examined the influence of tax fairness perception on tax compliance in Nigeria [20,38,41]. The first study was conducted before the amendment of Nigerian personal income tax act of 2011. Such an

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amendment was opined to be fairer as middle-class taxes were reduced and a small tax increase was placed the rich so as to demonstrate equity in the tax system [47]. The second and third study investigate only one dimensions out of the popular dimensions of fairness perception, for example Gberegbe *et al*., [20] examined only exchange with government which is one out of the ten popular dimensions of fairness perceptions. On the other hand, Muhammad and Dabor [38] examined only tax rate which is also one of the popular dimensions of fairness perceptions. However, the proposed model tends to incorporate other known popular dimensions of fairness perceptions such as general fairness, vertical fairness, horizontal fairness, personal fairness, retributive fairness and administrative fairness as dimensions to explain fairness perception.

Corruption is one of the key sensitive issue affecting virtually most of the developing countries including Nigeria. Based on the Transparency International Perception Index statistics which provide a score of 100 to 0 and indicate that countries that falls between 100 to 50 are those countries with less corruption while those between 50 to 0 are those with high level of corruption. In this report countries like Denmark, New Zealand, Finland, Sweden, Switzerland and Norway which falls in score between 85 to 90 are categorised as countries with less corruptions. While on the other hand countries like Malaysia, Hungry, Jordan, Romania, Cuba and Nigeria which falls within the score of 49 to 28 are categorised as countries with high level of corruption based on Transparency International Perception Index.

Another issue in Nigeria is that of corruption, which can affect negatively the trust citizens have in the tax system [12]. The fact is that Nigeria ranked among the most corrupt countries across the world standing at 139th in 2012 and 144th in 2013 in Transparency International's Corruption Perceptions Index though it remained stable at 136th in 2014 and 2015. In many aspects, corruption is related to trust, and trust, in turn, is related to fairness perceptions. Basically, trust affects the fairness perception in many respects, whereby citizens believe and trust the authority of their government. For its part, government can influence their perceptions. When a citizen believes that the government or authorities are trustworthy in handle their resources judiciously and achieve important things in return, this same citizen will, in turn, pay their taxes because of the good perception and trust they have in the government [4].

The mixed findings in previous literature have led to a call for further investigation. On their part, Baron and Kenny [44], argued that, when mixed results are found, a moderating variable should be integrated in the model to stimulate the relationship. This study proposes that trust in authorities can moderate the relationship between fairness perception and voluntary tax compliance in Nigeria, which serve as the major objective of the study.

The paper is divided into four parts. This part is an introduction followed by the literature review as the second part. The third part is conceptual framework developed in line with theory. The last part is conclusion and policy and future research implication.

2. Literature Review

2.1 Nigerian Tax System

As it was established in the Nigerian constitution that Nigerian taxations was enforced by three tiers of government that's federal, state and local government each where having varying degree of tax laws, tax administrations and tax policies [36, 43]. However, the following are taxes enforced by federal government which includes: 1) Companies Income Tax (CIT), 2) Petroleum Profit Tax (PPT), 3) Value Added Tax (VAT), 4) Personal Income Tax (PIT) (Only residence of capital territory, Arm forces and officers of the Nigerian foreign services), 5) Withholding Tax (WHT), 6) Education Tax (EDT), 7) Stamp Duties (STD), and Capital Gains Tax (CGT) [36]. Conversely, State government enforced the following taxes; 1) Personal Income tax, 2) License fees on television and wireless radio, 3) Stamp Duties, 4) Estates duties, 5) Gist tax, 6) Sales or purchases Tax, 7) Football tools and other betting taxes, 8) Motor vehicle tax and driver license fees, 9) Entertainment tax and 10) Land registrations and survey fees [1]. Finally, the following taxes were enforced by local governments in Nigeria: 1) Property tax, 2) Market and trading license, and fees [1].

The personal income tax which is the focus of this study was first established as community tax in North western Nigeria in the year 1904 prior to the amalgamation of the country in 1914, it was later changed to Native Revenue Ordinance for western and eastern region in the years 1917 and 1982 respectively [43]. The desire to tax personal income tax throughout the country leads to the establishment of Income Tax Management Act (ITMA) in the year 1961. Personal income tax for employment and salaried is based on PAYE which faces several amendments that resulted to the establishment of Personal Income Tax Act (PITA) of 1993 as amended [43]. However, the last amendment was made in 2011 due to the lack of fairness in the previous act which triggered this study to investigate whether change in tax law would affect fairness perception of taxpayers in Nigeria.

Despite the personal income tax amendment, studies pay little attention on the influence of fairness perception on voluntary tax compliance in Nigeria. Thus, this paper proposes a theoretical framework that attempts to explain the effect of fairness perceptions on voluntary tax compliance and the potential moderating role of trust in authority. Toward this end the following term would be investigated.

2.2 Voluntary Tax Compliance

Kirchler [27] defined voluntary compliance as a phenomenon that result of trust and cooperation between taxpayers and the tax authority and it is the willingness and desire by the taxpayer to comply on his or her own with the relevant regulations and directives of the tax authority. Voluntary tax compliance encourages taxpayers to comply with the tax laws voluntarily without compulsion by the tax authority. Based on this, taxpayers are expected to calculate their tax liability, report their income and file a tax return [48].

According to the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL, 2014), a voluntary tax compliance program is a program designed to facilitate the regulation of taxpayers' conditions vis-à-vis money and other assets that were previously incorrectly reported. The committee further argued that countries can introduce voluntary tax compliance for several reasons, which include among other things increasing tax compliance and honesty, raising revenue from taxes and/or encouraging asset repatriation because of economic policy. More importantly when a country is in an economic crisis, such a program can involve tax amnesty incentives and voluntary disclosure mechanisms among others.

Based on the aforementioned reasons for introducing voluntary tax compliance by MONEVAL this study is in line with the first rescan which stipulate that voluntary tax compliance can be introduce in order to increase the level of tax compliance and cooperation between taxpayers and tax authority.

Debate exists about the reasons behind voluntary tax compliance. Scholars like Feld and Frey [14], Feld and Tyran [17] and Frey and Torgler [18] have claimed that the response of voluntary tax compliance is an intrinsic motivation. Thus, the act of volunteering can also be part of a taxpayer's personal values, internal motivations, cognitive processes, social norms and sense of moral obligation, which can all help explain the rationale for voluntary tax compliance. Lubian and Zarri

[32] stated that numerous empirical studies have shown that taxpayers are adequately candid and may respond voluntarily to the fulfilment of their tax obligations. They further stressed that an individual may be driven by a positive interest in paying taxes. Thus, positive interest may signal an increase in voluntary tax compliance; on the other hand, negative interest may signal lower voluntary tax compliance.

Such an interest seems related to the association between perceptions of public good and tax payments. According to Levi [31] when taxpayers perceive drastic reductions in public goods when compared with the taxes they paid, these taxpayers will rationalize that government has failed in its contract with them. In turn, this may result in deteriorating voluntary tax compliance. Braithwaite [10] said that that taxpayer’s commitment towards volunteering in terms of payment of tax must be encouraged without compulsion. Indeed, OECD [46] said that providing good quality services to taxpayers strengthens their intention to embrace and comply voluntarily with the tax rules and regulations, which will, in turn, leads to the overall level of tax compliance.

Many variables have been studied with respect to voluntary tax compliance. For example, Hofmann *et al*., [24], who examined preconditions of tax compliance, stressed that if taxpayers and tax authority perceived each other as harmoniously pursuing the same community goals, then internal variables were more appropriate in encouraging taxpayer’s willingness to cooperate. Moreover, variables like government influence, perceived social norms, tax fairness, and motivational tendency to embrace tax laws are psychological determinants of voluntary compliance. Other authors have also examined why taxpayers comply. According to Tyler [64] if people perceive that compliance with the law is indeed appropriate, they, in essence, will assume the responsibility to voluntarily pay their taxes. Bornman [9] argued that voluntary tax compliance programs, if tailored effectively, will change the tax behaviour of taxpayers. He further explained that many business owners believe that such programs will not influence their behaviour as they are already tax compliant, but that it might change the behaviour of those taxpayers who are not compliant.

Few researchers have studied the issue of voluntary tax compliance in Nigeria. Modugu *et al*., [37] conducted a study on government accountability and voluntary tax compliance in Nigeria, with the aim of examining the connection between voluntary tax compliance and government accountability. The study was based on the theoretical frame work that a relational social/fiscal contract existed between citizens and state. They found that the perception of government accountability was a genuine factor that leads to the emergence and maintenance of voluntary tax compliance. Additionally, Bodea and Lebas [8] looked at how social norms impact voluntary tax compliance in urban Nigeria, where tax enforcement has traditionally been weak. They found that individuals with a positive experience of state services delivery were more likely to express belief in an unconditioned citizen obligation to pay tax than those who did not.

Voluntary tax compliance taxpayers are encouraged to cooperate, while tax cheating is totally absent [65]. Committed taxpayers consider contributions to public welfare as moral obligation or law, at the same time perceives the tax law and collections as fair [10]. However, voluntary tax compliance usually succeeds when there are motivational factors because taxpayers need to be encourage on certain things that can influence them to comply, such factors should include trust between taxpayers and tax authority and above all introducing transference and effective fairness in the tax system. In Switzerland for example a respectful and friendly treatments of taxpayers by tax authority was been observed for long period of time as an important strategy to enhance compliance [16]. They further, argued that in such situations, social distance would be low, voluntary compliance would prevail, while individual is less likely to consider the chances of evading.

Based on the above concept and definitions of tax compliance this study focuses on developing a theoretical framework on voluntary tax compliance because it appears to be more efficient and reliable determinant for generating huge amount of tax revenue from citizens and well-meaning taxpayers as argued by [27].

2.3 Tax Fairness Perceptions

Tax fairness can be defined as a platform based on an ideal that aims to create a system of taxation that is fair, clear and equivalent for all taxpayers ("Investopedia, 2017"). Overall, tax fairness looks to limit the amount of tax legislation and rules that benefit one segment of the tax-paying population over another ("Investopedia, 2017"). Indeed, fairness has been considered as part of the attributes of a good tax system [35].

Tax fairness plays a significant role in tax reporting behaviour [27]. Where a tax system perceived to be inequitable and unfair, this system usually leads taxpayers to evade tax payments and, in turn, making the tax system less relevant [49]. According to Gberegbe *et al*., [20], Adam Smith, a political philosopher who laid the foundations of classical free market economics, recognized the importance of tax fairness. Smith, who penned an inquiry into the nature and causes of the wealth of the nation's (1760) believed that fairness meant that a taxpayer needed to contribute to the development of their state based on their ability to pay or ultimately based on exchange of benefits they derived from government projects and development. Thus, fairness has been considered an attribute of a good tax system for centuries [35]. Therefore, looking at the importance fairness of tax system in encouraging taxpayers' compliance this study proposes to use six dimensions of fairness and the dimensions are adopted from Saad [56], this is because the six dimensions selected are more appropriate in the Nigerian context.

The dimensions include: vertical fairness, horizontal fairness, exchange fairness, personal fairness, general fairness, and administrative fairness [56]. However, the presence of these dimensions varies by country and context.

Perceived fairness relates to the equity and fairness of exchanges between people and their governments. In other words, it associated with the perception of the balance between public goods received, and the justice related to the breaking of rules [66]. With respect to the concept of tax behaviour, perceived fairness can be described through the concepts of: 1) distributive justice, 2) retributive justice and procedural justice [20]. Distributive fairness is defined as the fair exchange of benefits and costs as well as the fair exchange of resources, and, perhaps more importantly, how a taxpayer feels he is treated compared to another taxpayer [29].

According to Gberegbe, *et al*., [20] distributive justice fairness classified in to three main groups: 1) vertical, 2) horizontal, and 3) exchange fairness. Vertical fairness argues that different taxpayers of different ability and economic strength should be assessed using different tax rates [28]. This rationale clearly argues that lower incomes earners would pay tax lower than the higher income earner [56]. Horizontal fairness refers to "equal treatment of same individual with same circumstances" [53]. This is to say that individual taxpayers of the same economic situations should pay the same amount of tax. Finally, exchange fairness asserts that taxpayers can only cooperate in paying taxes based on the provision of public goods made available to them by the government. In other words, exchange fairness emphasizes that, only when a citizen perceives that there are good social amenities at their disposal in exchange for what they have paid as a tax, will they comply with tax law and pay their taxes [24]. Thus, the perception of the exchange of taxes with the government is influenced by the benefits received [35, 41].

Retributive justice is concerned with the norms or measures of the audit or punishment. Audit and punishment together with unjust penalties may create negative attitudes that create non-compliance with tax law [24]. However, retributive justice is related to enforced tax compliance which mostly resulted to negative attitudes by taxpayers.

Procedural justice is concerned with the perceived fairness and process of tax collection that relates to the distribution of scarce resource [29]. This is to say where relevant tax authorities employ a fair tax system taxpayers may be more likely to comply voluntarily [54,63]. The allocation of decisions usually made by a tax authority is assumed to be fair when citizens are free to voice their concerns regarding any decision that authorities make, and, at the same time, a situation in which the authorities make accurate decisions without sentiment or self-interest [33]. Compliance with tax laws will increase when tax authorities are perceived to be supportive [28].

Other concepts connected with fairness include: general fairness, personal fairness, administrative fairness, tax structures, special provisions. General fairness is concerned with the individual perception of whether the entire tax system is generally fair or not. Retributive fairness is centred on imposed rules and punishment, personal fairness deals with individual self-interest, and administrative fairness is concerned with the policy fairness; in other words, it is related to tax law procedures employed by the tax authority. Other tax fairness dimensions include a preference for either proportional or progressive taxation [62], special provisions [21,22,56]. Perceived fairness is interrelated with trust dimensions because just treatment of taxpayers helps in building and maintaining trust [27].

The level of fairness varies across countries. In comparison between Asia and America, Chinese and Koreans weigh fairness perception more greatly in forming overall fairness than do Japanese and Americas. The effect of distributive justice fairness on overall fairness is significantly stronger for Chinese than for Japanese and Americas. Japanese and Americas weigh perceptions for procedures justice more highly in forming overall fairness perceptions than do Koreans and Chinese [15]. From Nigerian point of view distributive justice is more relevant, this is because distributive justice relates to the allocations of scarce resources, promotions of equity across taxpayers and considerations of cost and benefit by taxpayers when comparing with what they receive in return of what they paid as tax.

Thomas's [59] study, which assessed tax fairness dimensions in the small developing economy of Barbados, investigated taxpayers' perceptions of tax fairness and examined whether Gerbing tax fairness perceptions applied in a small developing economy. The dimensions measured in the study were general fairness, exchange with government and self-interest. The findings showed "that taxpayer perceived the Barbadian tax system as relatively fair while focusing only on general fairness rather than exchange with government and self- interest" [59].

Evidence shows that fairness perception is a multi-dimensional construct with many countries having a distinct number of dimensions. For example, Gerbing [21] found only five dimensions of tax fairness in United States. Richardson [50] found eight dimensions of tax fairness perception in Hong Kong. Saad [56] found seven dimensions of tax fairness in Malaysia. Mustapha [40] found five dimensions of tax fairness in Nigeria prior to the amendment of personal income tax act of 2011. However, since the recent amendment, no study has conducted in Nigeria that examined the whole tax fairness dimensions in the country even though a change in tax law may affect the tax perceptions in the country [56]. In line with this development the following prepositions are made.

P2: Fairness Perception is multidimensional

Fairness perception is a relevant determinant for voluntary tax compliance. Gilligan and Richardson [22] studied the importance of the perception of tax fairness in forming compliance behaviour in a cross-cultural study of Australia and Hong Kong. Faial and Palil [19] conducted a study on fairness and individual tax compliance in Malaysia. The study divided the perception of fairness into three segments: 1) procedural fairness, 2) distributive fairness, and 3) retributive fairness. Only procedural fairness had a positive and significant correlation with tax compliance; distributive and retributive fairness had positive but insignificant correlations. Based on the above literature the following preposition where posited

P1: Fairness Perception has an effect on voluntary tax compliance

2.4 Trust in Government

Trust is defined as a special quality of relations for examples connected partners ascribe one another positive aspect and inner motivation to retain the relationship [13]. Trust simply refers to the belief that someone is safe and reliable or someone is honest and good and will not harm you. Trust can be seen as a legal arrangement whereby a person or organization exercise influence or control money and properties for another individual or organization [58]. Trust in authority relates to the general perception by a social group or individual that the tax authorities are working beneficially and benevolently for the common good [29]. The extant literature reveals that trust in authority is related positively to tax compliance [60,61]. Where tax authorities and officers treat taxpayers in a responsible and respectful manner, trust in the government as well as voluntary tax compliance may increase for individual, the group, or society at large [27].

Trust between a taxpayer and the tax authority usually results in a synergistic tax climate, and a synergistic tax climate asserts a mutual trust between the two parties (i.e., tax authority and taxpayer). In this synergistic climate, the tax authority believes that taxpayers pay their taxes due honestly, and, because of this mutual trust, the tax authority treat taxpayers with respect and humility then, taxpayers comply by paying their taxes when due [29].

The taxpayers understanding of how they are being treated by tax authorities and the mutual relationship and respect that exist between them can, in turn, encourage or influence taxpayers' loyalty and enthusiasm with compliance and paying their taxes honestly. This process is also called a psychological contract [15]. The vital role of trust in authorities can never be over emphasized as it encourages the willingness and cooperation of taxpayers to pay their taxes [30].

Trust has several dimensions as Robbins [52] noted. He identified five key dimensions of trust: 1) integrity, 2) competency, 3) consistency, 4) loyalty and 5) openness. Integrity, truthfulness and honesty are considered to the back bone of trustworthiness. If a government is perceived to be trustworthy because of its integrity, then an individual will be willing and enthusiastic in paying his/her taxes.

The second dimension of trust is competence. Competence has to do with the interpersonal and technical skills and knowledge individual leader may have. Walking the talk, which means doing what you say you will do, is often considered to be a must for trustworthiness in a leader. Competence as one of the dimensions of trust has a significance influence on the perception of trust because a citizen who perceives that his/her government is trustworthy engages in high tax compliance because she/he is confident that the government will not either waste or embezzle his/ her tax payments.

The third dimension of trust is consistency, which has to do with individual predictability, reliability and good judgment in tackling a situation. Where government is perceived to be consistent and simultaneously does what it promises to do, citizens will have more trust and, in return, comply with the relevance tax authority with honesty. They do this because they are seeing promises kept on the ground, the government is implementing good policies, and the policies align with the national interest.

The fourth dimension is loyalty, which refers to faithfulness or devotion to someone or some persons and advocates for their success. A citizen becomes more loyal to government especially where reciprocity exists; reciprocity here simply means that the government's provision of goods and services should align with the interests of the citizen, whereby a citizen is satisfied with government's effort toward providing social amenities. In return for the provision of these amenities, a citizen will become more loyal and eventually compliant.

The fifth dimension is openness. Openness relates to the ability of person or leader to give you the whole truth. Doing so is indeed among the most difficult tasks because most times the sensitive nature of the whole truth and the understanding of that truth do not match between people. Openness without any doubts creates an excellent level of trust, wherein government becomes more open about its activities and citizens perceive and understand the government's direction. This process will, in turn, result in taxpayers complying with the tax law and eventually improving voluntary tax compliance.

However, the above stated dimensions tend to be relevant in the propose study, this is because the propose study going to use trust as moderating variables and citizens can only develop sense of trust when the government or tax authorities poses virtually all the dimensions stated above. However, the measurement of trust of this study is going to be adopted from Wahl *et al*., [65].

Several scholars have studied the relationship between trust and voluntary tax compliance. Murphy's [39] study of 2,292 Australian taxpayers. The study shows positive relationship between trust in government and tax compliance. Additionally, Richardson [51], in a comparison of 47 countries, found that trust is positively related to tax compliance. In a series of experiments using students in Austria, Wahl, *et al*., [65] found that trust in government is positively related to voluntary compliance. Based on the above findings the following preposition were developed

P4: Trust have effect on voluntary tax compliance

Gberegbe *et al*., [20] found significance relationship between fairness perception and personal income tax compliance in Nigeria, while Mustapha [40] found that only two of the five dimensions he studied (special provision and exchange with the government) were significant with respect to perception of tax fairness in Nigeria. It is clear there is inconsistency in findings on the influence of fairness perception and tax compliance. Reference to the assertion of Baron and Kenny [44] that where mixed findings were found in previous literature a moderating variable should be integrated in the model to stimulate the relationship. Thus, in line with these arguments the following propositions are postulated

P5: Trust moderates the effect of fairness perceptions on voluntary tax compliance

3. Proposed Theoretical Framework

Based on the literature discussed above, figure 1 below depicts the proposed theoretical framework which shows the directions of the relationship between the exogenous and endogenous variables. Moreover, perceptions of relevant stakeholders, government and practitioners on the exogenous and endogenous variables will be solicited.

Equity theory was found to be suitable for the propose model because of its relevance in addressing the perception of fairness. Equity theory explains whether the allocation and distribution of resources are fair to relational parties, for example, taxpayers and tax authority. Equity is measured by looking at the costs to the benefits/rewards for an individual Adams (1976). However, equity theory posits that individual factors influence each person's assessment and perceptions of their association with their relational partners, in this instance, between taxpayers and tax authorities [23].

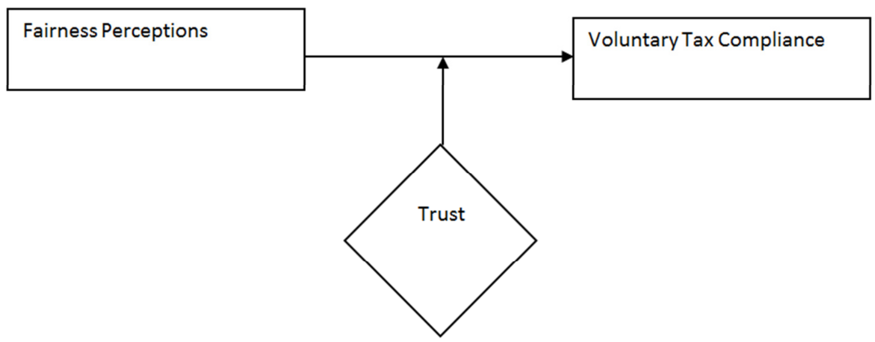

Fig. 1. Fairness perceptions, trust and voluntary tax compliance framework

The horizontal arrow depicts the direct relationship between fairness perception and voluntary tax compliance, while the second arrow shows the moderating effect of trust on the relationship between fairness perception and voluntary tax compliance.

3. Conclusions

The paper serves as a propose model on the effect of fairness perceptions on voluntary tax compliance with trust as a proposed moderator. As depicted in Figure 1 when the model is validated empirically, policy recommendation will be provided to the Nigerian government, Legislators, academia and other relevant stakeholders. Voluntary taxes have a great impact on the economic growth of a country. Where citizens perceived fair treatment from their government/tax authority the result is voluntary payment of taxes. Other countries facing decline in tax revenue would also benefit from the framework if validated as it may come up with insights for them to develop some appropriate strategies that can leads to voluntary tax compliance in order to improve their revenue base. Moreover, academia will also benefit from the study as it will provide additional evidence on factors encouraging voluntary tax compliance especially from the Giant of Africa (Nigeria). It will also benefit from the survey methodology as the research design, focus, scope and tools of the analysis will be different from the previous researchers that conduct study on fairness perception and voluntary tax compliance.

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