

ADVANCES IN TAXATION

Edited by John Hasseldine

ADVANCES IN TAXATION

VOLUME 28

ADVANCES IN TAXATION

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ADVANCES IN TAXATION VOLUME 28

ADVANCES IN TAXATION

EDITED BY

JOHN HASSELDINE

University of New Hampshire, USA



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INVESTOR IN PEOPLE

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INTRODUCTION

In Volume 28, there are seven chapters. In the lead chapter, Cass Hausserman, Susan Jurney, and Tim Rupert experimentally investigate how the level of government (either federal or state) and whether funding that is being allocated to enforcement or service efforts in a revenue agency affect trust in the revenue agency. They find that the two independent variables interact, such that trust in the state agency is not affected by whether the proposed funding would be allocated to service or enforcement efforts. But, at the federal level (the Internal Revenue Service), trust in the agency is significantly higher when the proposed funding is to hire additional service employees as opposed to hiring additional enforcement employees. Additionally, they find that the level of government moderates the mediating effect of trust in the agency on the relation between the use of funds and support for the funding.

Next, Hageman and Hausserman examine taxpayers' knowledge of tax incentives for charitable giving, and also the consequences of this knowledge on charitable giving decisions. Their first study establishes a baseline understanding of how making a charitable contribution affects taxpayers. In a second study, they experimentally manipulate the knowledge of taxpayers by providing an educational intervention; while measuring if, and how much, is donated in a hypothetical scenario. The first study indicates fewer than half of participants understand the basic principles of how charitable donations affect tax liability. Their second study reveals that a short educational video was extremely effective at improving taxpayers' understanding and helping them accurately estimate the tax benefit associated with charitable giving. Although they show that participants who received this educational intervention and accurately estimated the tax benefits in turn decreased their charitable giving suggesting taxpayers may be overestimating the benefit they receive from charitable giving, resulting in giving more than intended.

In the third chapter, Roberts and Roberts examine how public attitudes and judgments about tax fairness reflect distributive justice rules about proportionality/contributions, needs, and equality; fairness issues that influence voluntary tax compliance. The authors show that, viewed in combination, two distributive justice rules explain the tax fairness judgments of 89 percent of their sample and indicate surprising general agreement about what constitutes a fair share of income taxes that should be paid by US citizens from the 5th percentile to the 95th percentile of the income distribution. Roberts and Roberts conclude the joint application of the Needs rule of distributive justice theory and the

Contributions rule of equity theory indicates how seemingly competing, partisan distributive justice concerns can inform our understanding of social attitudes about tax fairness across income classes.

The next two chapters are related contributions. In the fourth chapter, Furner, Morrow, and Ricketts analyze how the designation of foreign earnings as “permanently reinvested” outside the US (PRE) is related to subsequent firm growth and market returns. They note that prior research suggests that firms that hold excess cash in foreign markets to avoid the US corporate income tax experience lower growth, since such “trapped” cash is inefficiently invested. However, foreign earnings can be inefficiently invested in forms other than cash. The authors hypothesize and find that as the ratio of PRE to total assets increases, firms’ growth rates decline. Their results suggest that trapped earnings, and not just trapped cash, are associated with lower growth. Because PRE has also been associated with earnings management in the literature, they also analyze the association between the use of PRE to meet or beat earnings targets and subsequent growth, observing a significant and persistent negative association.

Next, Furner, Walker, and Durrant examine whether the equity incentives of management are associated with an increased use of PRE. The authors predict and find strong evidence that the changes in PRE are positively associated with the portion of top managers’ compensation that is tied to stock performance. In addition, they find this relationship to be strongest for firms that met or beat forecasts, but only with the use of PRE to inflate income, suggesting that equity compensation incentives managers to opportunistically use PRE, especially to meet analyst forecasts.

Billings, Musazi, Volz, and Jones study the effectiveness of states’ research and development (R&D, used to represent creditable research expenses) tax credits. Prior studies consider the influence of state R&D tax credits by applying the statutory income tax and R&D credit tax rates. The authors reexamine the effect of a state’s entire tax burden instead of the statutory tax rates in moderating the effectiveness of a state’s R&D tax credit incentives. After controlling for several nontax factors in a regression analysis during the 2010–2013 period in 50 states, they find that statewide private-sector R&D spending is a positive function of the R&D tax credit and this effect increases with the overall level of the state tax burden. They attribute this finding to the fact that high tax burdens increase the present value of the R&D tax credits

Lastly, Lee and Nikitkov note that the rapid rise of electronic commerce has exacerbated consumer evasion as cross-border selling over the Internet has enabled foreign businesses to sell and avoid collection and remittance of tax on their sales. The authors search for the solution to this problem through the analysis of three tax collection models: Vendor, Financial institution, and Internet Service Provider (ISP). In addition, they examine administrative tools that enable more effective collection as well as inducements for taxpayers or collection agents to carry out their responsibility. Lee and Nikitkov conclude that

the ISP collection model is not feasible at this time. On the other hand, they find that the vendor model, when supplemented with appropriate administrative tools and inducements, as well as the financial institution model, both represent viable options for policymakers to consider.

John Hasseldine
Editor, *Advances in Taxation*

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THE EFFECTS OF LEVEL OF GOVERNMENT AND USE OF FUNDS ON TRUST IN REVENUE AGENCIES

Cass Hausserman, Susan Journey and Timothy Rupert

ABSTRACT

We experimentally investigate how the level of government (either federal or state) and whether funding is being allocated to enforcement or service efforts in a revenue agency affects trust in the agency, as well as support for the funding initiative. We find that the two independent variables interact, such that trust in the state agency is not affected by whether the proposed funding would be allocated to service or enforcement efforts. But, at the federal level (the Internal Revenue Service), trust in the agency is significantly higher when the proposed funding is to hire additional service employees as opposed to hiring additional enforcement employees. We also find that the level of government moderates the mediating effect of trust in the agency on the relation between the use of funds and support for the funding.

Keywords: Trust in the government; revenue agency funding; enforcement; service; support for funding; slippery slope framework

The IRS absolutely needs more funding. It cannot answer the phone calls it currently receives, much less the phone calls it can expect to receive in light of tax reform, without adequate funding.

—Nina E. Olson, National Taxpayer Advocate (as quoted in [Hoffman, 2017](#))

INTRODUCTION

The voluntary compliance system that serves as the basis for the US income tax system (as well as state income tax systems) relies on the fact that taxpayers trust the government to fairly and efficiently administer the tax system. For example, in calling for tax administration reform, then-National Taxpayer Advocate Nina Olson noted that the empirical data “suggest building trust with taxpayers... enhance voluntary compliance” (Hoffman, 2017). Unfortunately, in a [Pew Research Center Survey \(2013a\)](#), the public perceives the Internal Revenue Service (“IRS”) as the least favorable Federal agency with only 44% viewing the agency favorably.

In recent years, one of the most significant threats to the ability of the IRS to administer the tax system effectively is the budget and related workforce challenges that the agency has faced. Since 2010, the IRS budget has decreased by 18% (Horton, 2018) while its workload has increased with the number of individual returns increasing by 8% during that same period (IRS, 2018). Then-IRS Commissioner John Koskinen noted that these budget issues have a significant impact on the ability of the IRS to provide both the level of taxpayer service and the level of enforcement support that is required for the federal tax system to function effectively (*Tax Notes Today*, 2016). For example, since 2010, the number of IRS employees declined by more than 19%, with the decline in enforcement personnel dropping by 24% (Marr & Murray, 2016). Similarly, in the past few years, the level of service provided to taxpayers has drastically decreased, partially due to the budget cuts, as well as increased responsibilities of the IRS. For example, in the 2015 tax season, the IRS answered fewer than half of taxpayers’ phone calls (Debot & Marr, 2015). Ineffectual administration of the tax system by the IRS detrimentally affects the level of trust taxpayers have in the system.

The IRS is not alone in these challenges of improving services and enforcement while facing reduced budget resources and workforce issues. Many state revenue agencies have a similar challenge. Reissig (2016) states that the major challenges facing state agencies, particularly those that administer taxes, include economic conditions and budget fluctuations as well as an aging workforce. These challenges make it difficult for a state revenue agency to use their audit and enforcement time efficiently. Hamilton (2010) notes that many state tax administrators are searching for ways to reduce the tax gap for their state but that the most obvious answer is to increase resources, which has been a challenge given the budget constraints experienced by many states.

While it is widely acknowledged that state revenue agencies and the IRS are underfunded, garnering support for increased funding from taxpayers and voters is one of the biggest hurdles lawmakers face in increasing revenue agency funding. Given the challenges that both the IRS and state revenue agencies face in their efforts to increase services and improve enforcement with limited resources, we examine how taxpayers react to the allocation of funding for these purposes. More specifically, we expand the “slippery slope” framework developed by Kirchler, Hoetzl, and Wahl (2008), which describes the interrelated role of trust and power in tax compliance, to examine whether the level of government

(federal or state) and the use of the increased funding (service or enforcement) impact the level of trust that taxpayers express in the revenue agency.¹ In a fully crossed 2×2 between participants experiment, we provide participants with a scenario describing a proposed funding increase to their revenue agency (manipulated at either the federal or state level) that would be used to hire additional employees for the revenue agency (manipulated as either service or enforcement employees). Participants then respond to questions regarding their support for the proposed funding and resulting trust in the agency. We predict the two manipulated variables—level of government and use of funds—will interact to affect trust in the agency. Furthermore, we conduct an additional analysis to examine the relation between our manipulated variables, trust, and the level of support that taxpayers feel for increased funding initiatives. While federal and state lawmakers ultimately control the budget for these revenue agencies, support from citizens for funding initiatives is often a critical step in the process. For this reason, developing a better understanding of what impacts taxpayer support for funding is important.

Based on data from a sample of taxpayers recruited from the Qualtrics Panel, we test our hypothesis with an ANCOVA and find that the interaction of the level of government and the use of funds influence the trust that taxpayers have for the revenue agency. Specifically, the state revenue agency experiences the same level of trust from taxpayers regardless of whether the funds are used for enhanced service or enforcement. In contrast, the federal revenue agency experiences greater trust when the funding is used for enhanced services rather than when the funding is used for enhanced enforcement.

In an additional analysis, we conduct a moderated mediation analysis with level of government as a moderator and increased trust in the revenue agency as a mediator to examine the effect of these variables on support that taxpayers express for increased funding. In this analysis, the moderated mediation model continues to show a significant interaction between the level of government and the use of the proposed funding on trust in the revenue agency. In addition, this model provides evidence that our independent variables affect taxpayers' support for proposed funding indirectly through trust.

These findings contribute to the literature by enhancing our understanding of how taxpayers respond to information about the use of increased funding for revenue agencies. Prior literature (e.g., [Kirchler et al., 2008](#)) has suggested that enforcement and service both impact the compliance decisions of taxpayers. To date, this literature has not examined whether service and enforcement efforts have different implications on trust for varying levels of government. While we examine trust and support for funding instead of the compliance decision that is the focus of the [Kirchler et al. \(2008\)](#) study, we contribute to this literature by examining the effects for federal and state agencies. Furthermore, our additional

¹[Kirchler et al. \(2008, p. 212\)](#) define trust in this setting as the opinion that “tax authorities are benevolent and work beneficially for the common good.” [Prinz, Muehlbacher, and Kirchler \(2014\)](#) later expand the definition to include the belief that the tax authority works to provide services and support to make taxpaying easier and more convenient.

analysis demonstrates an important boundary condition related to the interplay of enforcement and service as we find that the allocation of funds for enforcement or service only matters when the revenue agency experiences differing levels of trust, as is the case with the federal revenue agency. Second, little attention has been paid in the academic literature regarding support for increased funding for revenue agencies so that they can efficiently and effectively administer the tax laws. Currently, most of the studies that investigate taxpayer reaction to funding increases have been sponsored by the IRS and have been survey-based. By using an experimental methodology, we are able to examine how taxpayers react differently to increased funding for the federal and state revenue agencies as well as whether the use of those funds has a different impact. Furthermore, the findings also have important implications for revenue agencies and politicians. By increasing our understanding of how taxpayers react to increases in funding, politicians who wish to champion increased revenue agency funding legislation can gain a better sense of what may be best supported by their constituents. Similarly, our results can help revenue agencies determine what funding requests their taxpayers may be most willing to support.

The remainder of the paper is organized as follows. In the next section, we review the literature on trust in the government, the level of government, and the use of funds and develop our hypothesis. We then describe the method used in the study, including a description of the participants and procedures. We next present the results, followed by a section that provides a discussion of the results and conclusions.

LITERATURE REVIEW AND HYPOTHESIS

Trust in the Government

Given the importance that trust of the citizens in the government plays in encouraging the efficient operation of government, it is not surprising that trust in the government has been the focus of considerable research. As the literature on trust in the government has developed, it has moved from investigations of understanding sources of trust (Hibbing & Theiss-Morse, 2002) and trying to better measure the construct (Hamm et al., 2011) to investigations into how trust may impact the perceptions of the government and support for its services (e.g., Herian, 2014).

An early theoretical approach to the level of trust in the government drew a parallel to a balance sheet and corporate decision-making (Miller, 1974). This conceptualization suggests that an exchange takes place between government and citizens in which the cumulative policies and decisions that politicians in power make are exchanged for trust in the government when they align with the beliefs and values of the individual. Conversely, when the cumulative policies are not aligned, government distrust results (Citrin, 1974; Miller, 1974).

As a result, researchers have investigated what other factors may influence or give rise to trust in the government. For example, public service performance, together with existing perceptions of government, impacts trust in government

(Van de Walle & Bouckaert, 2003). Song and Lee (2016) found that government use of social media increased perceptions of transparency, which in turn increased trust in government. Similarly, government trustworthiness also increases as citizens' use of the public sector social media increases. However, the use of e-government websites is negatively related to government trustworthiness when citizens' frequency of voice increases (Porumbescu, 2017). Nunkoo (2015) found that trust increased in local governments when there was a booming tourism industry in the area and that being involved in, and knowledgeable of the tourism helped citizens feel empowered and improved trust in the government.

Research has also examined governmental trust as an antecedent to several outcomes of interest. In his book titled "*Democracy and Trust*," Warren devotes a chapter to the question, "Should We Trust the Government?" The chapter summarizes that those who are most critical of the government are also the ones who are the most informed and are therefore in the best position to know whether the government and governmental actors are trustworthy. Therefore, government opposition by the most informed citizens when there are failings suggests that the "...possibility of trust could be important to the stability of government" (Warren, 1999, p. 31). Archival evidence also suggests that trusted and better-governed governments tend to have less severe business cycles, which has important implications for both monetary and fiscal policy (Bursian, Weichenrieder, & Zimmer, 2015).

Trust and Revenue Agencies

In examining the role of trust as it relates to revenue agencies, the literature has generally focused on two aspects—(1) the level of trust in the revenue agency (specifically the IRS in this stream of literature) compared with other federal agencies and (2) the impact of trust in the government on the perceptions and decisions of taxpayers (including the fairness of the tax system and the decision to comply with the tax system).

With regard to the comparative trust of agencies, Morgeson (2013) draws on the Expectancy Disconfirmation Model (EDM) to predict citizen satisfaction and trust in various government agencies and services. The EDM posits that as individuals have an experience or interaction with an agency, their prior expectations about the agency will either be confirmed or disconfirmed, which will affect satisfaction and trust in the agency. Given that different agencies have varying objectives and citizens have different expectations of them, it is perhaps not surprising that citizens might have differing levels of trust for these agencies. However, Morgeson and Petrescu (2011) investigated these potential differences further. They examined how qualities of service and information affected trust in six different federal agencies. Interestingly, the IRS stood out as unique from the other agencies on several dimensions. For example, prior expectations of IRS were directly related to satisfaction, which was not the case with other governmental agencies. The IRS was also unique in that both service and information were equally important in citizen satisfaction, whereas service alone dominated satisfaction for the other agencies in the study. Finally, the IRS was the agency in

which satisfaction and confidence in the agency were most strongly related to trust in the Federal government overall.

Further extending this literature, [Lee and Van Ryzin \(2020\)](#) investigated whether overall trust in the government was associated with the reputation of 12 different federal agencies. Using 2013 Pew Survey data, the researchers found a strong relation between trust in the government and agency reputation for all of the agencies. However, the perceived reputation was lowest for the IRS compared to the other 11 agencies.

As part of the second stream of literature related to trust in the government, researchers have examined how trust impacts the decisions of taxpayers. In most cases, these investigations have been surveys of taxpayer opinions about fairness and compliance (see, for example, [Vogel \(1974\)](#), [Song and Yarbrough \(1978\)](#), [United States Department of the Treasury \(1987\)](#), and [Jurney, Rupert, and Wartick \(2017\)](#)). Perhaps the most extensive investigation of trust in the government and taxpayer decisions was conducted by [Scholz and Lubell \(1998\)](#). Using both survey and tax return data from a sample of suburban taxpayers from two counties in New York, these researchers examined whether trust in the government affected the compliance decisions of the taxpayers beyond other variables known to have an impact (like fear and duty). Their results indicate that trust in the government has a significant effect on the compliance decisions of the taxpayers in their sample. In a paper further explaining the “compliance puzzle,” [Alm and Torgler \(2011\)](#) argue that many strategies are needed to combat tax evasion, including enforcement, service, and most interestingly for our current study, a “trust paradigm in which the tax administration needs to be aware that it can erode the ethics of taxpayers by its own decisions” (p. 636).

In the present study, we extend the literature examining trust and revenue agencies by focusing on two variables that may impact the trust that taxpayers have in the government. We examine the level of government as well as a service or enforcement focus. We discuss these factors, as well as the unique relationship between these factors and revenue agencies in the following sections.

Use of Funds and Level of Government

Use of Funds

Over the past few decades, revenue agencies have started to shift their focus from a purely enforcement focused agency to more of a service agency. These changes have been largely driven by public outcry and low customer satisfaction ratings and include efforts such as the creation of a Taxpayer Bill of Rights and appointment of a Taxpayer Advocate General.

Much of the theoretical and empirical research suggests that a service approach may actually help the revenue agencies collect more revenues ([Alm, Cherry, Jones, & McKee, 2010](#); [National Taxpayer Advocate, 2017](#)). Because complete enforcement would be too costly to achieve, most tax authorities rely on voluntary compliance to a large extent. Voluntary compliance is found to be higher when taxpayers are treated with respect, resulting in greater mutual understanding, trust, and cooperation ([Feld & Frey, 2002](#); [Frey, 2003](#); [Tyler,](#)

1990). Furthermore, while research finds an indirect effect between trust and noncompliance (Murphy, 2004), a service focus alone is generally not sufficient to collect the necessary tax revenues.

An interplay between trust and enforcement on tax compliance is outlined in the slippery slope framework developed by Kirchler et al. (2008). This model suggests that the level of taxpayer compliance is dependent on both the power of the tax authority (i.e., enforcement of the tax law through audits, fines, etc.) and trust in the authority (i.e., the belief that the tax authority works to provide services and support to make taxpaying easier and more convenient). Furthermore, they suggest that while increases in either trust or power will increase compliance, the nature of the increase in compliance will differ. When power of the authority is increased, the compliance will be enforced compliance. In contrast, when trust in the authority is increased, voluntary compliance will increase.

Since Kirchler et al. (2008) proposed the slippery slope framework, several studies have empirically tested the model. For example, Wahl, Kastlunger, and Kirchler (2010) provide support for this framework using an experimental methodology. In two experiments, one using students in a laboratory setting and one using self-employed taxpayers in an online setting, they find that increases in tax authority power create an increased level of enforced compliance, while increases in trust in the tax authority improve the level of voluntary compliance. Kogler et al. (2013) and Kastlunger, Lozza, Kirchler, and Schabmann (2013) confirm similar results in a number of additional countries, including Austria, Hungary, Romania, Russia, and Italy. Furthermore, more recent studies have extended the model to include other factors. For example, Kogler, Muehlbacher, and Kirchler (2015) examined how trust and power in the slippery slope framework relates to fairness perceptions and social norms. Olsen et al. (2018) expand the framework by incorporating emotions. While the present study does not examine compliance effects, the slippery slope framework remains a useful theory to help us examine the interplay between service and enforcement of the revenue agencies.

Level of Government

While the slippery slope framework suggests that taxpayers may respond differently to enforcement and service efforts, to date, this literature has not focused on potential differences between revenue agencies at different government levels. We acknowledge that resources are generally not malleable between federal and state agencies. However, examining the two levels of government in an experimental setting may shed light on underlying reasons for certain attitudes and behaviors.² Historically, citizens have had a more favorable view of state and local governments than the federal government. For example, Cole and Kincaid (2000) examine survey results from the 1970s to 1999 and generally find that

²In our experimental setting, participants are assigned to either the state or federal condition and are only asked to evaluate the scenario in terms of their assigned condition.

across a variety of dimensions, local and state governments are consistently viewed more positively when compared with the federal government. In relation to trust and confidence that a specific level of government is doing a good job in carrying out its responsibilities, their respondents for the 1999 survey had a relatively high degree of trust in the local and state governments, with 67% and 69%, respectively, indicating a great deal or fair amount of trust in these levels of government. In contrast, only 56% indicated this level of trust with the federal government. Similarly, 36% of their respondents identified the federal income tax as the least fair tax versus 27% who identified state income or sales taxes and 29% who identified local property taxes as least fair.

In recent years, favorability ratings for the federal government have been declining, while favorability ratings for state and local governments have generally remained steady (Pew Research Center, 2013b). One concern related to the declining numbers for the federal government is that this may weaken the trust that citizens have in the government.

In the present study, we examine whether the level of government impacts the extent to which taxpayers believe that a proposal to increase funding to either the federal revenue agency (IRS) or a state revenue agency will increase their trust in the revenue agency in the future. Prior studies on trust in the government have suggested that citizens are more likely to identify with more local levels of government (Box & Musso, 2004). Thomas (1998) suggests that citizens are more likely to interact with state and local level officials than federal officials, so they are perceived as being more accessible and familiar.

Through surveys, researchers have also found that weakening trust in the government is driven by perceptions that government is inefficient and wastes money (Baldassare, 2002; Nye, 1997). Given the number of highly publicized issues that the IRS has faced in recent years, taxpayers may be likely to trust their state revenue agencies compared to the IRS when considering a proposed funding increase. Alternatively, it may be that the perceived inefficiencies of the federal government will lead to greater support for funding and for an increase in trust for the IRS in order to correct these inefficiencies when compared with state revenue agencies. To examine these possibilities, we posit the following hypothesis:

H1. Taxpayers will express different levels of trust based on how the revenue agency uses funds (i.e., customer service efforts vs enforcement efforts) depending on the level of government (i.e., state vs federal).

Support for this hypothesis will provide us with the opportunity to further examine the role that trust plays. More specifically, we plan to run an additional analysis to investigate whether trust mediates the taxpayer's level of support for funding proposals. A prior study by the IRS (2017) suggests that taxpayers generally support increased funding for the IRS. Results from this survey found that 68% of taxpayers agreed that the IRS should receive extra funding to provide more services while 57% agreed the IRS should receive extra funding to provide greater enforcement. However, this survey study does not examine what may influence the level of support for each of these initiatives. Refining our understanding of the role that trust plays in the relation between the use of funds and