

**FORUM ON TAX ADMINISTRATION:
SMALL/MEDIUM ENTERPRISE (SME)
COMPLIANCE SUBGROUP**

Information Note

**Understanding and Influencing
Taxpayers' Compliance Behaviour**

November 2010

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ABOUT THIS DOCUMENT

Purpose

This information note describes the findings from a survey to member countries and studies of scientific literature on taxpayer compliance behaviour. The purpose is to describe current knowledge on taxpayer compliance behaviour in order to assist countries in their effort to cost effectively influence taxpayer behaviour to improve compliance.

Background to the Forum on Tax Administration

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs (CFA) in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams from OECD and selected non-OECD countries.

In 2009 participating countries developed the *FTA vision* setting out that... *The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world.* This vision is underpinned by the FTA's key aim which is to..... *improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.*

In carrying out this mandate, the FTA's work is directly supported by two specialist Sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries, and a number of more focused task groups. The Compliance Sub-group's mandate, in broad terms, is to provide a forum for members to:

- periodically monitor & report on trends in compliance approaches, strategies & activities;
- consider & compare member compliance objectives, the strategies to achieve those objectives & the underlying behavioural compliance models and assumptions being used;
- consider & compare member compliance structures, systems and management, and staff skills and training; and
- develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

Since its inception, the Sub-group has focused its work on issues associated with improving the tax compliance of SME taxpayers. The Sub-group meets annually to review and discuss developments, to provide oversight and direction of its work program, and to provide a forum where members can exchange experiences and approaches for improving taxpayers' compliance.

Caveat

National revenue bodies face a varied environment within which they administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance.

The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country's practices to fully appreciate the complex factors that have shaped a particular approach.

Inquiries and further information

Inquiries concerning matters raised in this note should be directed to Sean Moriarty (Head, International Co-operation and Tax Administration Division) at e-mail (Sean.Moriarty@oecd.org).

Summary

All revenue bodies share a common mandate. This mandate is to ensure a high level of compliance with the various tax laws and regulations in place within their jurisdiction. In order to ensure compliance, it is incumbent upon a revenue body to influence the compliance behaviour of its taxpayer population.

Influencing taxpayer behaviour is not a new concept in tax administration as evidenced by the vast array of programs in place to assist taxpayers comply as well as to deter taxpayers from non-compliance. However, what is relatively new is the extent of research being undertaken to better understand what motivates tax compliance. Better understanding of taxpayer behaviour can be expected to place revenue bodies in a stronger position to design and implement effective compliance strategies, which contributes to the sustainability of taxation systems.

This information note contains an extensive review of compliance literature on the subject of influencing taxpayer behaviour as well as the results obtained from a questionnaire sent to revenue bodies participating in the Forum's Compliance Sub-group. The findings of the note are presented under six main headings: (1) Deterrence; (2) Norms; (3) Opportunity; (4) Fairness and Trust; (5) Economic factors and (6) Interactions. The key findings are as follows:

Deterrence

- Deterrence resulting from audits, the risk of detection and/or severity of punishment is the primary response that comes to mind when the general public is asked about how a revenue body promotes compliance; however, studies demonstrate conflicting evidence as to whether deterrence strategies have the desired behavioural influence on compliant and non-compliant taxpayers—some revenue bodies have reported that deterrence activities (large audit adjustments and monetary penalties) have actually emboldened taxpayers to behave more non-compliant in subsequent years. For the habitual non-complier, a deterrence strategy involving recurring audit activity may be required.
- The success of deterrence strategies is also linked to a taxpayer's norms. Of particular interest is the finding that deterrence is more effective where strong social norms exist. Therefore, revenue bodies may wish to consider the use of non-monetary penalties that attach a "social cost" form of response to non-compliant behaviour.
- Research findings suggest that communication plays a critical role in how a deterrence strategy is perceived by taxpayers. It is not sufficient to simply deliver a message that non-compliant taxpayers are being detected; the public must also be reassured (truthfully) that most taxpayers are honest, as this promotes a strong social norm to remain compliant. Otherwise, deterrence communication can give the impression that non-compliance is the norm and thus running the risk of promoting further non-compliance.

Norms

- Norms, both personal and social, are considered by revenue bodies to be the most important drivers of compliance. However, influencing taxpayer norms is not an activity in which most revenue bodies have a great deal of experience. Instead, revenue bodies have tended to focus on short-term, output-driven indicators of performance. They have historically been reluctant to engage in longer-term strategies designed to regularly assess (using outcome measures) and permanently influence taxpayer behaviour. Most revenue bodies now recognise the need to adopt a longer-term approach based on outcomes (compliance levels).
- Aside from attempting to influence norms, revenue bodies should consider incorporating normative messages in their dealings with taxpayers. For instance, messaging that others have acted in a certain manner (i.e. taxpayers have changed their behaviour or have complied) can influence those that have yet to do so.

- It is also important for revenue bodies to be alert to, and promptly address, public misconceptions or inaccuracies that may impact social norms (hence taxpayer behaviour). For example, if a media story suggests that taxpayers are being dealt with unfairly by the administration, or that tax evasion is more widespread than in reality, a response to the effect that this is a rare case, or is not true based on factual evidence, should contribute to public trust.

Opportunities

- Revenue bodies have traditionally sought to limit the opportunities for non-compliance and have expended much less effort on making it easier for taxpayers to comply. For example, third party reporting, withholding regimes, and regular legislative amendments have been used and are seen as effective in minimising non-compliant behaviour. However, revenue bodies have tended to overlook the “lazy non-complier” – the taxpayer who would have complied if only it had been easy. Further research could also be undertaken to better understand why taxpayers unintentionally non-comply, such as by making errors in completing forms. Suggestions to make it easier to comply as well as to reduce unintentional non-compliance include the use of plain language in communications and simplifying forms and tax laws where possible.

Fairness

- Research suggests that fairness, as exhibited by the revenue body or government, can play a role in taxpayer behaviour. Three types of fairness are discussed in the note. *Distributive fairness* is the perception that the government acts as a good custodian and wise spender of tax revenues. *Procedural fairness* is the perception that the revenue body adheres to procedures that are fair in dealing with taxpayers. *Retributive fairness* is the perception that the revenue body is fair in the application of punishment when the rules are broken. Studies show that a lack of fairness is linked to a taxpayer's inclination (or justification) to not comply.

Economic factors

- The work undertaken indicates that there has been, in general, a lack of research to link economic factors to taxpayer compliance behaviour. The general conclusion is that factors that promote economic growth also tend to promote tax compliance.

Interactions

- Not to be overlooked from the research is the need to better understand how the various drivers of compliance behaviour interact with each other. In particular, a revenue body must be cautious when using controlling and supportive approaches to influence behaviour. For example, if a revenue body's approach is perceived as very controlling, it can cause taxpayers to feel distrusted. Research implies that when taxpayers feel distrusted, they may adopt the same attitude towards the revenue body, and this may reduce compliance. A revenue body should send a clear signal to the general public that non-compliant behaviour is seen by society as wrong. By suggesting that society (and not just the revenue body) view this behaviour as wrong existing personal norms are reinforced.

While there is no simple answer as to how best influence taxpayer behaviour, the findings described in the note suggest that revenue bodies adopt a compliance strategy which combines both a deterrence approach and a normative approach. The deterrence approach should be used to create and support social norms – to signal that society does not approve of non-compliant behaviour. In the long run, high levels of compliance are achieved preferably by establishing and reinforcing norms in favour of compliance. Not only are norms considered by both researchers and revenue bodies to be the most effective way to influence behaviour, they are also the least costly.

Given the demand for increased efficiency and effectiveness, it becomes more important to undertake research to understand taxpayer behaviour. Through a better understanding of taxpayer behaviour, revenue bodies can make more effective use of their limited resources to develop strategies which will have a true (i.e. outcome-based) and sustainable impact on taxpayer compliance. An increase in taxpayer compliance will put governments on a more sound financial footing. In this context, it is also worth noting that much of the academic research done to date has tended to be directed at understanding and influencing the behaviour of individual taxpayers (including the self-employed). Revenue bodies could, accordingly, benefit significantly from research directed at understanding the compliance behaviour of corporations and the role of tax intermediaries and other third parties in this.

I. Introduction

Background

1. At the April 2008 meeting of the Forum's Compliance Sub-group, delegates discussed the possibility of undertaking work regarding taxpayer compliance behaviour. The Sub-group's work with treatment has highlighted the need to know more about this subject. Every treatment has the purpose to influence taxpayer behaviour to some extent. In order to do that and to find the most effective treatment, revenue bodies benefit from knowledge about taxpayer behaviour. That is knowledge about patterns of behaviour, the main drivers behind the behaviour and about the ways and possibilities to influence these drivers through interventions and treatments.
2. The purpose of the work is to collect and share knowledge on taxpayer compliance behaviour. The result should be a practical help that enables revenue bodies to use the Compliance Risk Management Framework in a more effective way. The idea is to provide knowledge that can be of practical use, not to prescribe how things should be done. The purpose is to present a general and practical analysis on this subject. The report should be considered an introduction to the subject.
3. The work is based on a questionnaire that was distributed by the Compliance Sub-group and studies of literature undertaken by expert officials, co-ordinated by The Netherlands and Swedish revenue bodies. The questionnaire sought information on compliance research activities and perceptions on compliance behaviour. Participating countries were also asked to fill out templates to describe their research findings.

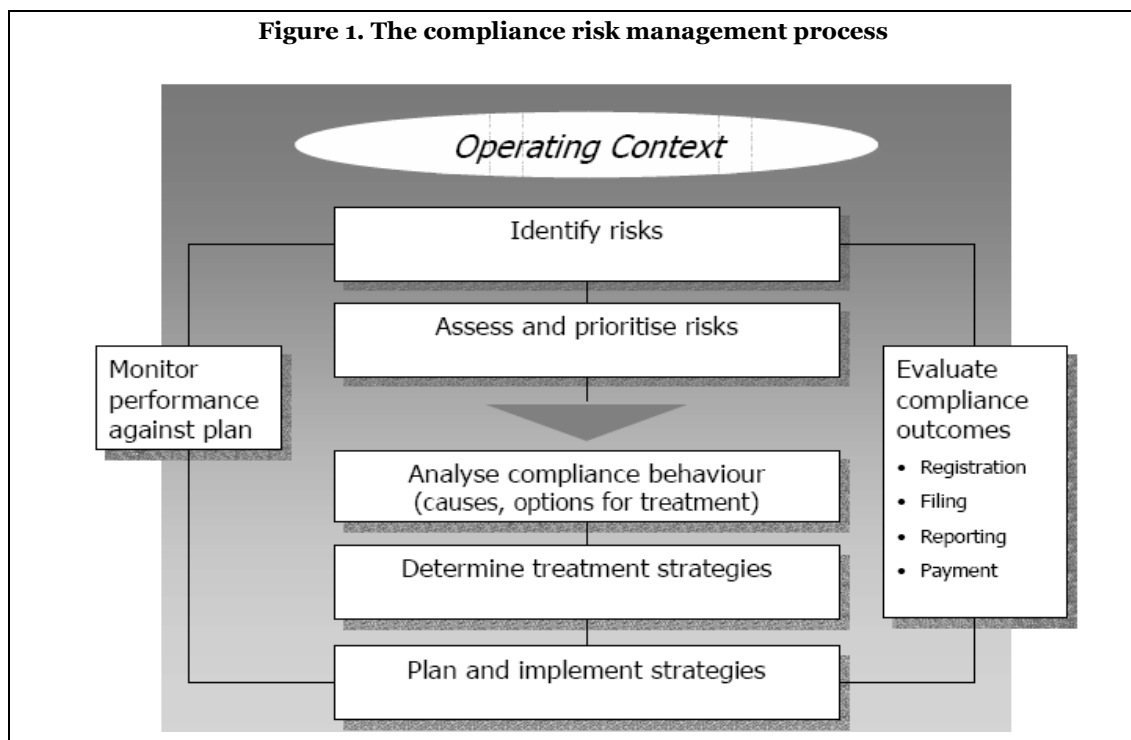
This report

4. This report focuses on findings from a survey to revenue bodies and knowledge derived from the scientific literature over recent decades. The survey provided insight into research carried out or commissioned by revenue bodies and how knowledge on taxpayer behaviour is used in practice.
5. The report will not replicate or replace previous work published in the Forum's guidance note '*Managing and Improving Compliance*' published in 2004. Rather, it aims to set out more knowledge and provide an update with the latest findings.
6. The information note will focus on drivers of tax compliance behaviour. The central question is to understand behaviour in order to be able to influence it. The report therefore has a strong practical orientation.
7. The information note aims to be descriptive and informative and not prescriptive. The knowledge provided can be used in different ways and can have different implications for different countries, due to situational and cultural differences.
8. The survey, among other questions, contained an item on what, according to the participating countries, would make the information note useful and practical. The answers to this question can be categorised into four almost equally often mentioned types of questions that countries would like to see answered. These questions were on:
 - **Research findings:** What are the results from research on compliance and its predictors from other countries and how do we share this knowledge?

- **Implementing knowledge in practice:** How do we get from knowledge to actions?
 - **Effective treatments:** How and through which factors do different interventions or treatments influence compliance and how can we improve these interventions to become more effective?
 - **Research methods:** How should we or how do other countries assess or measure (non) compliance; what are the appropriate methods of research within this field; and, do we need a theoretical framework, and if yes, which one?
9. This note does not provide all the answers to these suggested questions. It will however try to give an idea about the type of findings, some examples of how knowledge could be implemented into effective treatments and the annex provides a first insight into the research methods that are used.

Influencing taxpayer behaviour

10. The guidance note '*Managing and Improving Tax Compliance*' states that "Confidence that any action taken will be successful grows from a clear understanding of what is motivating the non-compliant behaviour identified." To understand non-compliant and compliant behaviour is crucial to designing the right form of treatment. It is also important to have some insight into the effect of different forms of treatment on behaviour.
11. The guidance note presents the Compliance Management Process as a framework. It is clear from this process that knowledge on behaviour is central in order to choose the right form of treatment. The process is shown in Figure 1 below.



12. The purpose of gaining a better understanding of taxpayer behaviour is to be able to effectively influence that behaviour. All revenue bodies are generally required to achieve as good a compliance outcome as possible (i.e., to maximise the overall level of compliance with

the tax laws). For this purpose, they are appropriated a finite level of resources, meaning that careful decisions are required as to how and in what ways those resources are to be applied. Revenue bodies generally aim to increase the level of voluntary compliance. This is important because there is a difference between enforcing compliance and fostering voluntary compliance. Influencing taxpayer behaviour is therefore about increasing the willingness to comply and about enforcing the law if necessary.

13. The behaviour of the taxpayer is a result of his/her personal norms and experiences related to a specific context. The context is the social and economical environment and the society in general and includes the activities of the revenue body and its interactions with taxpayers. A change in context can change the behaviour as well as changed norms or experiences. So, if revenue bodies gain more knowledge on compliance behaviour and change their activities and behaviour, this in itself can lead to a change in taxpayers' behaviour. Drivers behind behaviour cannot be separated from context and to influence drivers means changing the context.
14. A revenue body can influence taxpayer compliance behaviour directly or indirectly. Directly through direct interventions targeting specific groups of taxpayers or indirectly by changing the context in which the taxpayer operates. It can change the context by changing the way it operates itself or by influencing the context through others, for example by investing in enhanced relationships with 3rd parties, for instance tax intermediaries, industry associations or other governmental bodies. Successful strategies to influence behaviour therefore depend on insight in the specific circumstances of the taxpayers.
15. It is therefore important to have some insight into how for instance deterrence works, when it will work, when it will not work and how it can be improved. It is of course equally important to have knowledge on the effects of other types of treatment and knowledge that can give us ideas for new forms of treatment. More knowledge on behaviour is therefore very valuable for the practical work carried out by revenue bodies. Knowledge and understanding of behaviour can directly be transformed into practical day-to-day operations.

Things to be aware of

16. Taxpayer compliance concerns human behaviour and is complex. This also means that it is a complex task to influence behaviour. Drivers and context are interlinked in ways that we currently do not fully understand.
17. Aiming for changes in taxpayer behaviour will likely ask for major changes in revenue body behaviour. To focus on behaviour in terms of compliance means that the effectiveness of the Revenue Body has to be measured in terms of outcome and this puts more focus on outcome-measurement (the impact on behaviour) instead of output-measurement.
18. Part of a successful strategy is to constantly learn more about behaviour. It is important to share knowledge between revenue bodies and to continue to carry out research and study long-term effects of interventions. Better ways of measuring outcome will also provide more knowledge on the effects of treatments and interventions on behaviour that can be used to further improve compliance strategies.

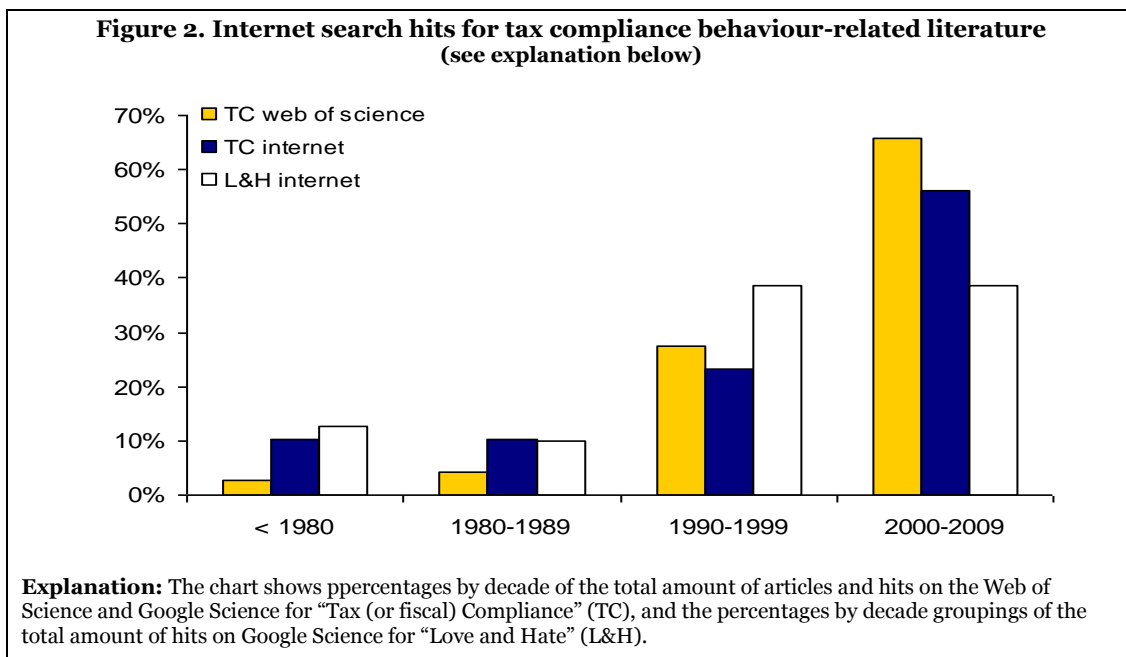
II. Research on tax compliance and taxpayer behaviour

Introduction on scientific research

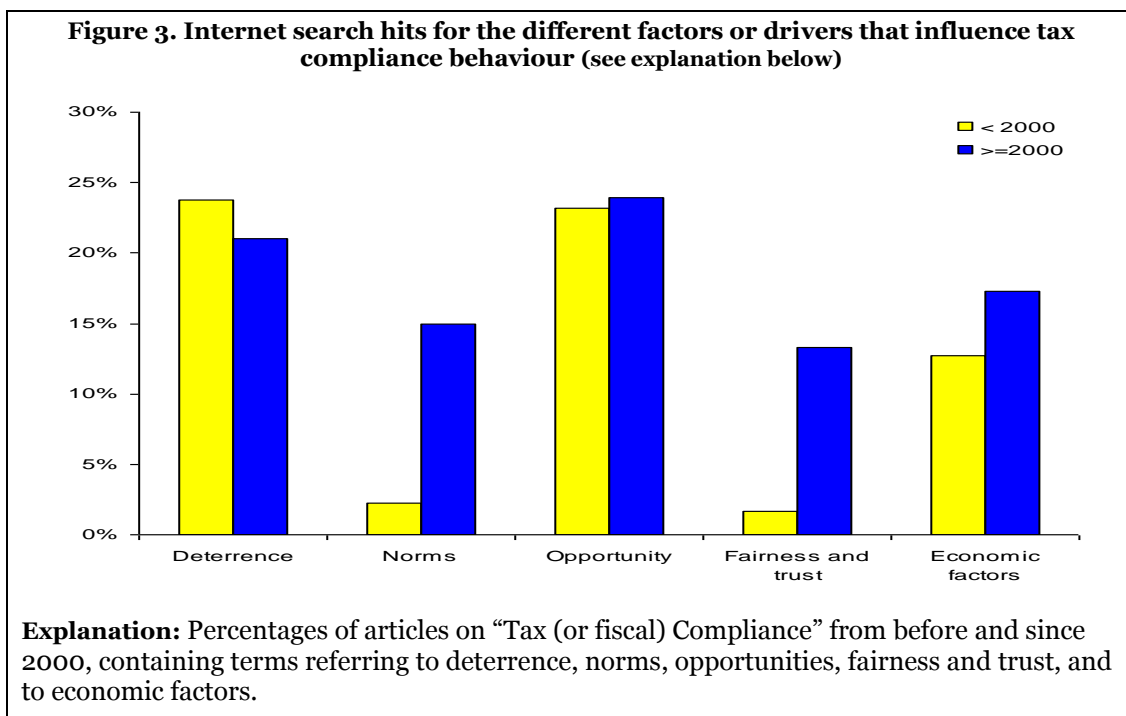
19. Scientific research on tax compliance and taxpayer behaviour is a relatively new area. In the last three decades the number of scientific publications devoted to the subject has grown exponentially. It started in the 1970s with simple economic models and has since then expanded with a broader behavioural perspective and more complex explanations.
20. The classic economic model of tax evasion from the 1970s (Allingham and Sandmo, 1972) assumes that people are behaving in an economical rational way. In this view, compliant or non-compliant behaviour is the result of a cost - benefit calculation. People comply when the costs of evasion outweigh the benefits of evasion and do not comply when the balance tips to the other side. Typical benefits of tax evasion are the unpaid taxes, while typical costs are the risk of getting fined and the severity of the fines.
21. Following the model's logic, in order to increase tax compliance, effort should be directed at increasing the frequency of audits and the severity of the fines. The model is therefore also referred to as the economic deterrence model and appears to have been very influential for the enforcement practice of (among others) revenue bodies.
22. But the model does not predict nor explain actual levels of compliance (Frey, 2003). The classic economic theory predicts much more tax evasion than is observable. If people were making a rational decision based purely on economic factors as to whether or not to pay their taxes then most taxpayers would be involved in tax evasion or fraud because of the low probability of detection and the small penalties (Alm, McClelland & Schulze, 1992).
23. Because of these shortcomings, several attempts have been made to adapt the classic economic model of tax compliance. But this has not resulted in a model that effectively describes and predicts tax behaviour (Kirchler, 2007). As a result, other than economic factors have been placed in the foreground. Recent studies of tax compliance have a stronger focus on sociological and psychological factors. Especially, attention has been directed at the role of personal and social norms and justice or fairness considerations.
24. Another area of interest has been behavioural economics where behaviour is described based purely on empirical evidence on how people actually behave, both experimental studies and real world data. Studies in the field of behavioural economics clearly show that humans do not behave as fully informed, economic rational and purely self-interested decision makers. Because of their limited information processing capabilities, individuals use heuristics and are susceptible to biases in their decisions (see for instance Thaler & Sunstein, 2008). Note that this does not mean that it is impossible to understand, explain or predict behaviour. But the heuristics and biases that affect the taxpayers' decisions and behaviour should be taken into account.
25. The opportunity for tax evasion (or compliance) has also a great impact on taxpayer behaviour. In terms of keeping evasion in check, strong empirical support can be found for limiting the opportunity that potential tax evaders have for avoiding. For example, tax withholding systems work well, not only reducing opportunity for evasion, but also saving on compliance costs. Third party reporting has also been shown to improve compliance, lending credibility to enforcement capacity in the process (Braithwaite 2008).
26. The increasing knowledge on taxpayer behaviour has caught the interest of revenue bodies and is influencing compliance strategies. The shift from the classical economical model of

- rational agents to an understanding of behaviour can have great impact on how a revenue body designs its work.
27. The literature concerned with the drivers behind behaviour most often takes the point of departure in individuals or social groups. Only little of this body of literature has businesses as a focus. The literature still holds evidence of several relevant findings, also for businesses, but there might be a need to “translate” or adapt this literature to also fit the reality of businesses.
 28. While businesses constitute such an important segment for revenue bodies, there is a need for more conceptual and empirical work that focuses on the drivers and mechanisms behind tax compliance behaviour of businesses. One emerging and promising perspective in this respect is the relation between corporate governance and businesses' compliance with laws and regulations (e.g. Van Oosterhout, 2009).
 29. Knowledge of the drivers of tax compliance behaviour can help to delineate strategies and interventions that impact these drivers and thus behaviour. But also more general knowledge about human behaviour and principles of persuasion can be extremely helpful to increase the effectiveness of communication and treatments (e.g. Cialdini, 2009).
 30. Research with a broader behavioural perspective has identified a large number of factors and drivers that are associated with tax compliance. Of particular policy significance is the finding that personal ethical norms can drive tax compliance, with deterrence playing a role when obligation and social pressure fails. Moral obligation and anticipated feelings of shame and guilt have emerged as significant factors in explaining compliance and are regarded as among the most consistent predictors in the literature (Braithwaite 2009).
 31. Based on the findings in the research the factors and drivers behind taxpayer compliance behaviour can be categorised into five main categories:
 - Deterrence, e.g. audits, perceived risk of detection and severity of sanctions;
 - Norms, both personal and social norms;
 - Opportunity, both to be compliant (e.g. low compliance costs, easy rules) and to be noncompliant (e.g. opportunities for evasion);
 - Fairness, related to outcomes and procedures, and trust, both in the government or tax authority and in other taxpayers; and
 - Economic factors, containing general economic factors, factors related to the business or industry and amount of tax due.
 32. In the last decade tax compliance has received a growing amount of attention both from scientists and practitioners. The Web of Science, which only contains scientific articles, holds a total of 528 articles. Of these articles 66% (347) were published in 2000 or later. Google science returns an astonishing 187.100 hits for “Tax (or fiscal) compliance”. Again most hits (56% or 187.100 hits) are from the past decade. Figure 1 portrays the percentages of articles on the Web of Science and hits on Google Science per decade, compared to the total amount. The number of scientific articles and the amount of information on the internet have overall grown over the past decades. To give insight in the relative growth of interest in the subject of tax compliance an additional variable is added. The variable “love and hate” is used for this purpose since these terms are expected to receive equal interest in all decades.

33. Figure 2 shows that the amount of scientific output on tax compliance has been growing over the past decades. Up until 2000, the growth of this output can hardly be called spectacular when compared to the amount of “love and hate” hits. Since 2000 the topic “Tax Compliance” also relatively does seem to have gained much more attention.



34. To get an idea of the scientific attention that the different factors or drivers of tax compliance have received, additional analyses were conducted using the ‘Web of Science’. Figure 3 portrays the percentages of the articles from before 2000 and from thereafter that contain keywords referring to the different factors or drivers in combination with Tax (or fiscal) Compliance.



35. Figure 3 shows that the attention before 2000 mainly focussed on *deterrence* and *opportunity* as drivers for tax compliance, and somewhat on *economic factors*. Since 2000 *norms* and *fairness and trust* have also gained considerable attention. However, in the first decade of this millennium *deterrence* and *opportunity* still seem to dominate the literature on Tax Compliance.
36. In the following part of this chapter these five factors and drivers are described. For each category of factors and drivers, first of all results from the scientific literature are listed. Secondly, the importance of these factors and drivers according to the responses to the questionnaires are mentioned. Finally, practical implications of this research are mentioned as well as examples of research conducted by revenue bodies. More explanation about the questionnaire and the outcomes are given in a separate annex called questionnaire responses: tax compliance research.

Factors and drivers that influence taxpayers' compliance behaviour

Deterrence

37. Deterrence is based on the concept that the risk of detection and punishment will improve compliance behaviour. Under this approach citizens pay their taxes out of fear that the government will catch and penalize them (Lavoie 2008). The aim of deterrence is therefore mainly to prevent tax evasion but the concept also includes the idea that the punishment of an evader will discourage future evasion.
38. The standard model of deterrence was first formulated by Allingham and Sandmo (1972), who adapted Becker's (1968) model of the economics of crime. The model is based on an assumption that taxpayers are economical rational and act to maximise their self-interest. This model has been widely criticised mainly because in reality taxpayers are more compliant than the model predicts. The odds of detection and penalties are generally so low, that according to the model it would be rational to cheat; yet most people tend to pay their taxes (Braithwaite 2008).
39. The relationship between deterrence and tax compliance is complex. Research on the effect of deterrence conducted by revenue bodies and academic research show different results. Valerie Braithwaite (2009) has described deterrence as a *double edged sword*. Deterrence can strengthen the moral obligation to pay tax because it points out what is the right thing to do. But deterrence can also create resistance from the taxpayer by feelings of oppression. Thus, deterrence can have a positive or negative effect on compliance. The question therefore is not whether or not revenue bodies should use deterrence, but how it can be used most effectively. Some studies on the relationship between deterrence and compliance are mentioned below.
40. Deterrence can be better understood if people's general economical behaviour is considered. As mentioned above, humans do not act in a total economical rational way. The research on *behavioural economics* draws on insights from economic experiments to bring a deeper understanding of human behaviour into economic theory.
41. An early and important paper in behavioural economics was written by Kahneman and Tversky in 1979 (Prospect Theory). This paper explains a number of economic decisions that diverge from classical economical theory. The most important deviation is *loss aversion*.
42. Loss aversion means that people tend to give potential losses greater weight than potential gains. People are far more tolerant of a foregone gain than a loss, even though in economic terms they are equivalent. People also respond differently to risk according to whether it involves potential gains or losses. While they are generally risk averse for gains (e.g.

preferring a certain \$50 to a 50% chance of \$100), they actually become risk seeking where losses are concerned (e.g. most choose a 50% chance of losing \$100 over a certain loss of \$50) (Reeson & Dunstall 2009). Unexpected tax arrears will be perceived as a loss. Therefore taxpayers may be willing to take big risks in order to avoid the loss, for instance by being non-compliant (and facing the possible risk of detection and punishment). An unexpected tax refund will be perceived as a gain. People don't want to jeopardise the gain and becomes risk averse, they are less willing to be non-compliant and facing the risk of detection and punishment. The same factors can be applied when a businessman facing a crisis and perceive a risk of losing his business. This is a great loss. The person can in these cases be willing to take big risks in order to avoid the loss.

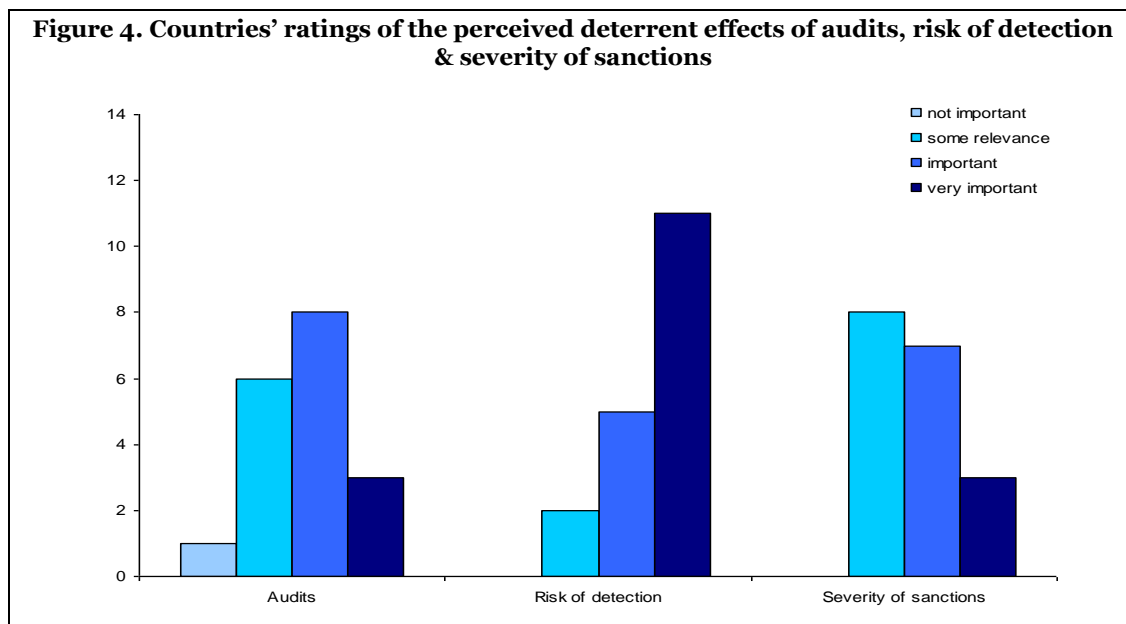
43. Economic studies (Fischer, Wartick and Mark, 1992) have found that an increase in detection probability has a general positive effect on compliance. This effect is however found to be very small. Furthermore, research shows that the effect of fines on tax compliance is usually also very small or negligible (Braithwaite 2008).
44. The relationship between deterrence and compliance has also been examined in numerous *surveys* in the past few decades. Some of these studies show that deterrence and tax compliance are indeed associated. People who assess the probability of detection and the level of penalty as being low are more inclined to evade tax than people who assess this deterrence as being relatively greater (Grasmick & Scott, 1982; Vogel, 1974). However, evidence is not conclusive. In other surveys the opposite has been found to be true (Spicer & Lundstedt, 1967; Wärneryd & Walerud, 1982).
45. Besides surveys, a number of *experiments* have been done to test the effect of deterrence on compliance. Hessing and colleagues, for example, concluded from a series of field and experimental studies that deterrence has little or no influence on compliant taxpayers. In the case of non-compliant taxpayers, they concluded that it is possible that deterrence could even encourage evasion (Hessing, Elffers, Robben, & Webley, 1992). However, some revenue bodies found the opposite effect. UK conducted research on the preventive effects of audits using data from random enquiries undertaken in 2000 and 2001 (see Box 2 below). The research shows that audits appear to generate positive preventive effects for the non-compliant taxpayers but negative preventive effects for the compliant ones. The example from New Zealand (see Box 1 below) also shows positive effects from audits.
46. The effect or importance of deterrence cannot be understood without considering the context in which it is applied. Of particular policy significance is the finding that personal norms (moral obligation) can be the main driver for tax compliance but with deterrence playing a role when moral obligation and social pressure fails (Wenzel, 2004).
47. When personal norms in favour of compliance are strong, deterrence will have weak effect on compliance. Taxpayers then comply because they think it is the right thing to do, not because they are afraid of punishment. But when personal norms are weak, deterrence becomes more important (Wenzel 2004). If the taxpayer is not affected by a moral obligation to pay tax then the threat of punishment can have a positive impact on behaviour.
48. The opposite is true for social norms. When social norms in favour of compliance are weak, deterrence will have weak effect on compliance, but when social norms are strong, deterrence will have a greater impact on behaviour (Wenzel 2004). This means that formal sanctions (deterrence) work better if there is a social cost associated with it. Other people need to perceive the punished behaviour as wrong.
49. The deterrent effect is moderated by the strength of prevailing personal and social norms. But there exists also an influence in the opposite direction, i.e. deterrence can influence norms. Deterrence can for instance create or support social norms by signalling which behaviour is disliked and liked. Lederman (2003) argues that sanctioning people who do not comply can

reassure others that they are doing the right thing. People become more willing to comply if they perceive others are complying as well.

50. The situation is, however, more complex when it comes to personal norms. Research indicates that deterrence can weaken or strengthen personal norms. Deterrence can undermine a personal norm in favour of compliance if the external pressure on the individual is perceived to be controlling. This effect is referred to as 'crowding out' (Bohnet, Frey & Huck, 2001; Frey, 2003). Interventions are perceived to be controlling if they are too intrusive or hard, leaving no room for the individual to make a choice. If a person wants to comply and at the same time feels forced to comply, the willingness to comply can be reduced. But an intervention can also be controlling by not recognising the individuals' own good intentions. In that case self-esteem can suffer and the individual can react by reducing his motivation.
51. Besides 'crowding out' there can also be a 'crowding-in' effect when interventions are not perceived as controlling but as supportive. Deterrence can provide an incentive that crowd-in a persons own personal motivation. This will be the case if the individual perceive the interventions to be supportive instead of controlling. In that case self-esteem is fostered because the individuals own conviction is recognised and the individual reacts by strengthening his motivation.
52. It is clear that deterrence is an important driver for behaviour. But the effect of deterrence differs between individuals and contexts and thus needs to be used in the right way in order to work effectively. Deterrence could in this respect be most effective as a tool for supporting existing social norms in favour of compliance.

Practical implications and examples

53. A majority of respondent countries rate audits, risk of detection and severity of sanctions as important drivers of compliance. Especially risk of detection is perceived as very important. Figure 4 presents the importance attached to these deterrence factors.



54. By understanding the way deterrence works in practice, a revenue body can design its enforcement activities in a more effective way. The example provided in Box 1, drawing on research of recently audited taxpayers carried out by the New Zealand Inland Revenue

department (NZ IRD), suggests that audits may improve compliance among businesses. The central issue here is not, as mentioned before, whether deterrence works or not but how and when deterrent measures could be applied effectively and when not. The challenge for a revenue body is to utilise a strategy that creates positive effects at both the individual level (i.e. among those that have been audited), and on a general level (i.e. for those taxpayers that have not been subject to the enforcement activity) at the same time. This means that revenue bodies do not only need to perform audits in an effective manner and among the right taxpayers, but also to communicate about these actions to the public in an effective way.

Box 1. Deterrence—NZ IRD research of recently audited taxpayers

To understand the likely effect of an audit on future compliance behaviour the NZ IRD commissioned telephone interviews among 300 recently audited businesses. A little over half (54%) of the interviewed businesses stated that they had done or would do things differently in the future in order to meet their tax obligations. Specifically, this had or would include engaging a tax agent, ensuring everything is done correctly or having checking systems or improving record and book-keeping and keeping more detailed accounts.

55. To enhance the effectiveness of deterrence, tax administrations may consider communicating the reasons for selecting certain taxpayers for treatments such as audits or investigations. Even if tax administrations are not willing to share the details of case selection, they can at least share the belief that different types of taxpayer behaviour exist (eg. the pyramid) and how the selected compliance treatment corresponds to each type of behaviour. Articulation of such information would enhance transparency and let taxpayers better understand how tax administrations work. This could strengthen public trust in the tax administration.
56. As indicated above, practical research on the effects of deterrence on compliance on both an individual level and on a general level show a mixed and complex pattern of results. Enforcement activities may strengthen the perception in the general audience that compliance is the right thing. Audits and especially convictions sometimes appear to promote stronger personal norms. Compliance may also be bolstered if compliant taxpayers notice that non-compliant taxpayers are being caught and punished.
57. Deterrence may, however, also undermine personal norms among compliant taxpayers and thereby undermine an important drive among the general public to remain compliant. Communicating through the media about evaders and successful (large scale) audits by the revenue body may create an impression that evasion is widely spread, or put in other words, promote a strong non-compliant social norm (see next section), and thus undermine compliance. This while in most countries evaders are actually a small minority. The challenge is therefore to explain to the public that most taxpayers are honest but the few exceptions are successfully being caught. This is a very practical lesson that can be used in communications activities.
58. Both on an individual level as on a general level the effects appear to be dependent on the right selection of taxpayers that are audited. Confronting the willing with (possible) harsh treatment and threatening them with severe penalties may provoke adverse effects. The United Kingdom's Her Majesty's Revenue and Customs carried research on the preventive effects of random audits among the compliant and the non-compliant underline this point (see Box 2). Auditing taxpayers that already are compliant appears to undermine their willingness to comply. Support and assistance directed at preventing unintentional mistakes are more likely to bolster compliance among such a group. Of course ex ante it is difficult to know which taxpayers are compliant and which are non-compliant. Improvement of selection strategies could assist revenue bodies in targeting their audits on intentional non-compliant taxpayers.

Box 2. Deterrence—UK HMRC's study of the preventive effects of random audit activities

The UK conducted research to assess the likely preventive effects of audits using data from random enquiries of self-assessment taxpayers undertaken in 2000 and 2001. The research was split into three groups or segments of taxpayers: 1) medium-sized businesses; 2) non-complex individual taxpayers; and 3) small-sized businesses.

Additional tax yield generated by audit enquiries was identified by comparing tax and contributions before and after the audit. Any change was then compared with that of a control group (taxpayers who were not audited) using the difference-in-differences methods.

The research focused on the identification of preventive effects which occur after the enquiry has been closed. Overall, the research showed mixed results for compliant taxpayers (i.e. those with a zero correction, representing 78% to 83% of the population) and non-compliant taxpayers. Generally audits appear to generate positive preventive effects for the non-compliant and negative preventive effects for the compliant. Other findings were as follows:

- Analysis of the medium-sized businesses segment provided strong evidence of positive preventive effects for non-compliant taxpayers and negative effects for the compliant in the first year after the closure of the enquiry.
- Analysis of the non-complex individuals segment showed strong evidence of negative preventive effects for the compliant. The estimated preventive effects for the non-compliant are not statistically significant from zero.
- For small-sized businesses there was evidence of positive preventive effects for the non-compliant and estimated preventive effects for the compliant were not statistically significant.
- Analysis of the preventive effects two years after the end of the enquiry provided mixed results. Estimates were statistically significant from zero only for non-compliant taxpayers in the medium-sized business segment and for compliant taxpayers in the non-complex individuals segment.

59. There is however no guarantee that trying to deter a non-compliant taxpayer will lead to improved behaviour. Box 3, which describes the results of an experiment conducted by Mexico's revenue body—the Servicio de Administración Tributaria (SAT)— gives an example of the absence of positive effects of deterrence among the most non-compliant taxpayers, while the more compliant Mexicans appear to improve their behaviour after receiving a threatening letter from their revenue body. A possible explanation could be that deterrence may promote calculating reasoning. Especially already calculating non-compliant taxpayers may become even more non-compliant due to deterrence. This may even happen after large corrections and severe penalties. If evasion has been profitable for fraudsters for a long period of time, the financial loss due to an audit might be seen as an unlucky strike. This temporary set back can be compensated in the future by increased evasion. Audits may also paradoxically strengthen illusions of security, by provoking reasoning like "lightning never strikes twice in the same place" and "I survived this storm, I'll survive the next".

Box 3. Deterrence—Mexico's SAT experiment with warning letters sent to selected taxpayers

Prior to 2006's income tax return filing season, a letter was sent to 31,754 individual taxpayers. Tax evasion studies had shown that self employed taxpayers, as well as those with entrepreneur activities, are among the groups of individual taxpayers with the highest evasion rates. Given this, the program was targeted on these groups, each one comprising about a half of the selected sample. *Since Mexico's SAT (the Servicio de Administración Tributaria) is adopting risk analysis techniques, it was declared of interest to analyse if taxpayers' behaviour differs, depending on its risk level, which was already estimated.*

The main goal of the experiment was to detect a different behaviour on risk perception among this kind of taxpayers, as well to motivate voluntary and on time compliance. In the letter, they were

advised to report their correct income and deductions; if they fail to do so, the tax authority could employ its verification powers.

To evaluate the performance of the program, a control group of taxpayers, who did not receive the letter, was selected. Cases on treatment and control groups were selected via random stratified sampling, proportional to risk stratum and individual taxpayer segment (self employed or entrepreneur).

Relevant fields of the tax return, for the fiscal years 2005 and 2006, were compared, using a difference in differences estimator, in order to test for differences among the treatment and control group, as well as among risk levels. Furthermore, contingency tables analysis was used to determine if there is a relationship between tax return filing and the reception of the letter, discriminating among taxpayers' risk level.

The results of the study showed that taxpayers on the treatment group reacted as expected (i.e. they increased their disclosed income more than similar taxpayers on the control group). This outcome holds, when the analysis is carried separately among the self-employed and among those performing entrepreneurial activities. Also, statistical evidence showed that tax filing compliance was higher among taxpayers on the treatment group (80% of the taxpayers on this group filed a return, while the compliance rate was 67% on the control group). Also, it was found a significant statistical relationship among risk level and compliance exist. Evidence showed that the program had significant impact on the behaviour of taxpayers tagged as of medium and low risk. No statistical evidence was found regarding a change in the behaviour of high risk taxpayers between both groups (treatment and control).

60. Taxpayer's reactions to an audit are far from solely determined by the monetary result (the amount of the reassessment and the height of penalties). The influence of procedures, i.e. the auditors handling of the case, may by far outweigh its influence on the behaviour of the taxpayer. A high degree of perceived procedural justice will most likely result in a better effect, than when the procedures surrounding the audits are unjust in the eyes of the taxpayer. A perception of procedural justice may be promoted in many ways, for instance by an auditor taken the taxpayer's view into account and treating the taxpayer with respect and empathy. This type of auditor behaviour will most likely lead to an acceptance for what the revenue body is doing, even if the taxpayer may not be happy about the personal financial consequences of the encounter.
61. It is probably impossible to find one final practical strategy for the effective compliance promoting use of deterrence. Generally it might be wise to use deterrence prudently. On an individual level deterrence seems to be relatively effective in improving compliance behaviour among those who intentionally evade out of calculative and monetary motives, however probably only before they are fixed in a fraudulent routine. This suggests that audits and personalised deterrent communication should preferably focus on this group of evaders at an early stage. First time evaders could be found among new taxpayers or among starting businesses. The amounts concerned (corrections and fines) may often be relatively minor; first times evaders normally evade less tax than more experienced ones. The long term effects on compliance however may be enormous. It is extremely important to select the right taxpayers for this strategy because compliance among the much larger group of willing taxpayers may be damaged by this approach. To pinpoint the right group can be difficult. Besides, revenue bodies could try to design audits (for example when performing random audits) in such a way that they do not (only) evoke deterrence, but rather create trust and promote strong personal and social norms.
62. For the hardened and experienced fraudsters audits and deterrence may only work if administered consequently and over a long period of time. This means following audits up by more audits and thereby making it impossible for them to make a profit out of evasion, or alternatively, fining them out of business. This will most likely require a long and time consuming commitment for the revenue body, but it seems important for the general perception that these fraudsters are being closely watched by the revenue body.

63. The loss aversion can be used in practice to influence behaviour. Revenue bodies could point out what the losses would be if the taxpayer doesn't do the right thing. For example, cost for not filing or paying on time (Cialdini, 2009).

Norms

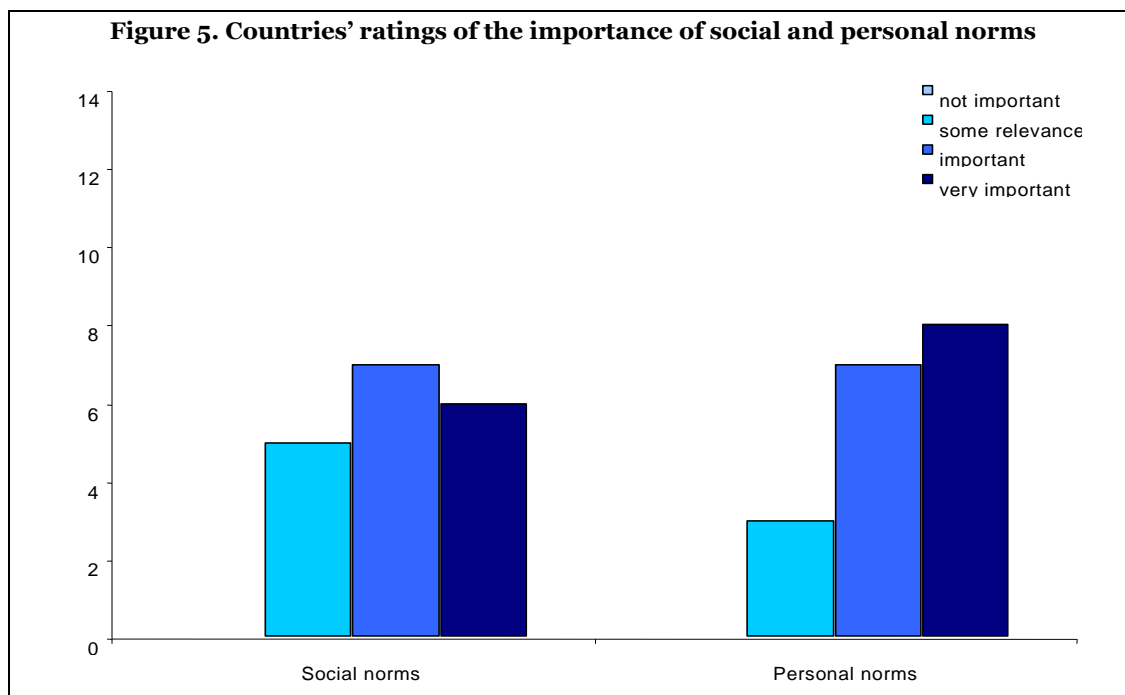
64. Moral or normative considerations are found to be an important determinant of tax compliance. Taylor (2001) points out that there is a connection between risk of detection, formal sanctions and compliance, but the research shows that the fear of experiencing feelings of guilt and the risk of social stigmatisation has a considerably greater deterrent effect. These drivers (conscience and social acceptance) behind taxpayer behaviour have attracted more and more attention over the past few years. Studies so far have generally focused on personal norms, often referred to as tax ethics, tax mentality or tax morale (e.g. Braithwaite & Ahmed, 2005), and somewhat less on social norms.
65. Personal norms can be defined as the deeply rooted convictions about what one ought or ought not to do. In psychological models that aim to describe or predict behaviour, personal norms are one of the key variables (e.g. Fishbein & Ajzen, 1975). In the tax context, personal norms can be defined as the belief that there is a moral imperative that one should comply (Wenzel, 2005). Personal norms with regard to taxes reflect a taxpayer's values and tax ethics (Kirchler, 2007). Personal norms are also related to different personality characteristics, such as egoism and honesty.
66. Someone's personal norm or morale with respect to rules and regulations does not develop overnight. Personal norms are rooted in core values and develop as a result of long-term socialisation processes. As a result personal norms are not influenced easily. Nevertheless, because of their huge influence on behaviour, personal norms may well be the focus of a compliance strategy even though the impact may only materialise in the long run.
67. Social norms can be defined as the behaviour, ideas and convictions among social groups. Social norms evolve and are modified through social processes within and between the groups. Hence, norms are not static but still have certain continuity due to their social character. Norms of a particular social group influence the behaviour of people that identify themselves with that group.
68. Research shows that opinions and behaviours of others, or the ideas one has about others' opinion and behaviour, are of great importance for taxpayer compliance behaviour (e.g. Wenzel, 2004). With respect to these social norms, a distinction can be made between *descriptive* social norms (what others do or what we think others do) and *prescriptive* social norms (what others think about certain behaviour or what we believe others think). Descriptive and prescriptive social norms with respect to certain behaviour are usually strongly related. In research both types of social norms are therefore often combined. But this is not necessarily the case. In some situations descriptive norms and prescriptive norms do not have the same impact on behaviour (Reno, Cialdini & Kallgren, 1993).
69. Several studies show that people are inclined to follow the behaviour they see others perform. Research by Cialdini and colleagues acknowledges that information about what others do has a profound impact on behaviour. For instance, the presence of litter in a park (descriptive norm) impacts subsequent littering behaviour by others (Cialdini, Reno & Kallgren, 1990). Similarly, seeing someone acknowledge an existing rule or norm and behave accordingly (prescriptive norm), also stimulates norm-conform behaviour (Reno, Cialdini & Kallgren, 1993).
70. Two processes underlie these effects. First of all, behaviour of others signals so-called 'social proof' that the behaviour is the right behaviour in the given circumstances (Cialdini, 2001).

Secondly, people tend to behave as others do because of the threat of social exclusion. People do not want to deviate from the majority, even if they do not entirely agree with the consensus behaviour (Asch, 1956).

71. A study by Scholz and Lubell (1998) shows that people are more inclined to meet their tax obligations when they trust that others will also pay their fair share. Furthermore, perceptions of how others will judge tax evasion, affects ones own tax compliance. Particularly, when the others are a relevant group that one belongs to or identifies with (Wenzel, 2004). Other studies also found a relation between perceptions of the behaviour of others and the attitude towards tax evasion (e.g. De Juan, Lasheras & Mayo, 1994; Webley, Cole & Eidjar, 2001). People who object to paying taxes also believe that others do not comply with tax rules. This relationship is stronger when it concerns close others, such as friends and family (Brooks & Doob, 1990; Hasseldine, Kaplan & Fuller, 1994).

Practical implications and examples

72. Figure 5 presents the importance of personal and social norms in stimulating compliance according to the participating countries. Compared to other drivers, norms on average are rated as the most important drivers.



73. It is important for a revenue body to have some basic understanding of the effects of norms and adapt its strategies accordingly. Practical use of this knowledge should probably not be restricted to specific strategies aiming at influencing norms. Everything a revenue body does can resonate with norms about paying taxes. Therefore it may be wise to consciously incorporate normative appeals in all actions; in mass media campaigns, letters send by the revenue body, on the website and in moments of personal contact. The example in Box 4 describing the Netherlands Tax and Customs Administration 'Tax Accounts Project', concerning the use of foreign bank accounts, provides an example of research indicating the importance of normative appeals in promoting compliance.

Box 4. Norms—Netherlands' Tax Accounts Project

In late 2000 and early 2001 the Fiscal Intelligence and Investigation Service/Economic Investigation Service (FIOD-ECD) of the Netherlands Tax and Customs Administration obtained information on thousands of Netherlands nationals who, collectively, held a huge amount of capital in foreign bank accounts. This information resulted in what was called 'The Accounts Project'. The primary objective of the project was to deal with the account holders identified en masse or intensively. It also hoped to achieve the greatest possible indirect knock-on effect—voluntary disclosure by as many as possible of those persons who held a foreign bank account but who had not yet been identified.

The Accounts Project has mainly brought that effect about through media publicity. The Tax and Customs Administration actively sought publicity by setting up a website and placing an advertisement to publicise the voluntary disclosure scheme that allowed taxpayers to declare (and pay tax plus interest on) previously undeclared foreign bank balances without being fined. There was considerable contact with journalists concerning the project.

This study examined the content of media reports on the Accounts Project (67 articles published in national and regional dailies during the period November 2001 to September 2002) and related this content to the influx of voluntary disclosers. Of all the elements in the media reporting on the Accounts Project, normative messages appear to have had, by far, the greatest positive influence on the number of new voluntary disclosers. This applies both for prescribed norms ("it is wrong not to declare a foreign bank account") and perceived norms ("a lot of other people have already voluntarily declared their foreign accounts").

In addition to normative messages, reports about the possible ways of making a voluntary disclosure had a beneficial effect on the number of new voluntary disclosers. Again, the number of disclosures increased a few weeks after the reports appeared.

A very large proportion of the media reports dealt with the risks of detection and the consequences for those suspected of holding undeclared foreign accounts. However, these elements in reports did not appear to have much direct influence on the number of new voluntary disclosers.

74. Personal norms, once internalised, are generally difficult to change. It is an illusion that a single encounter with an auditor, a tax letter, or a media campaign will drastically improve the recipient's deeply rooted personal morale. This does not imply that the revenue body can't influence personal norms at all. Long running campaigns, for instance, on environmental conscious behaviour or aimed at discouraging drink driving prove in many countries that personal norms and subsequent behaviour can be changed in society. However, the revenue body will, in order to be successful, need to be patient. When personal norms are not yet strongly developed the chances of successfully influencing social norms in the short term are better. From this point of view, the Swedish campaign "Or you can pay tax", aimed at influencing the tax morale of teenagers might work. Most youngsters have little experience with taxes and their ideas about paying taxes are still bendable.

Box 5. Norms - Spanish media campaign for reinforcing personal norms

On 5 March 2010, the Spanish Council of Ministers passed the "*Plan for the Prevention and Correction of Tax, Labour and Social Security Fraud*". This Plan widens the collaboration among Public Bodies in charge of fraud control in order to improve their effectiveness, and it is based on three main instruments: the shared use of information, the design of joint performances and more co-ordinated actions in the recovery of taxes and social security contributions.

Among the joint measures, there is a series of measures about promoting voluntary compliance, reinforcing taxpayers' personal norms about the negative effects of fiscal fraud and social security fraud through a media campaign. Through this campaign the different administrative bodies responsible for these different areas will join their efforts in a common campaign which will emphasise the negative effects of all kinds of non-compliance, especially in a situation of serious deficit in the Spanish budget.

The campaign will highlight the benefits that all Spanish society will get from these attitudes and behaviours to face the economic crisis and recover from it.

75. In most countries the majority of people are already characterised by strong personal norms concerning paying tax; they really want to do the right thing (Frey, 1999). A revenue body can use the existing personal norms by stressing them or reminding the taxpayer of their existence (e.g. "It's important that we all pay our due amount of taxes"). It may be especially helpful to encourage people to actively express their compliant norms or attitudes. People generally want to be consistent in words, attitudes, and deeds. After actively stating (for instance by concluding compliance agreements) that it is important to pay tax, for most people, it would feel inconsistent not to actually do so.

Box 6. Norms— Canadian research on compliance postures

In 2002, 2003 and 2005, the Federal Provincial Territorial Underground Economy Working Group, a partnership between provincial and federal tax administrations, developed a set of tax compliance questions for a syndicated survey that has been gathering data on values, motivations, and behaviours of Canadians since 1983. The objective was to construct detailed social profiles of Canadian taxpayers based on their stated attitudes and behaviours towards tax compliance and linked to their broader, self-declared set of core values and beliefs.

Statistical analysis identified six compliance segments (altruistic compliers; deferent compliers; pseudo-compliers; situational non-compliers; potential non-compliers; and rebels), each distinct from the population as a whole and from each other. These segments were named according to their propensity to, and reasons for, tax cheating. At one end of the spectrum, there are those who strongly oppose tax cheating. At the other end is a small group that is deliberately and repeatedly non-compliant.

This knowledge is being used to develop customized compliance strategies (these are still being tested). It is also directing more targeted quantitative and qualitative research exploring industry segments considered to be at a higher risk for non-compliance, such as different self-employed segments.

76. Positive personal norms can also be used in another way to influence behaviour. For instance, a person can have a strong personal norm for wanting to do the right thing and be a good citizen. But the person can at the same time perceive that a little tax evasion is a very minor offence and it will therefore not violate his personal norms. By influencing that person's perception by convincing him that all tax evasion is serious, the behaviour can be changed without changing the underlying personal norm (cf. Cialdini, 1989). This can be a very effective way of influencing behaviour because most people have strong personal norms in favour of honest behaviour. Some studies show that 90-93 % of taxpayers identify themselves as moral taxpaying citizens (Braithwaite 2006).
77. Some people personally do embrace a high moral tax standard, but find themselves confronted with conflicting norms or perceptions. For instance they perceive that tax evasion is widely spread, that the revenue body is unjust or that the tax money is spent in the wrong way. Such notions may lead people to justify tax evasion. They may convince themselves that under the circumstances evasion is not so bad. Revenue bodies should constantly be aware of such threats to compliance in society. When such conflicting norms or perceptions are unrealistic, revenue bodies can counter them by actively providing the correct information about the accurate state of affairs, and simultaneously confirming the tax morale. When the conflicting norms or perceptions are realistic (for instance tax payers are treated unfair), the revenue body, together with their partners, should aim at addressing the cause of the problem, and actively communicate their actions.
78. When personal norms on tax paying are absent or negative (e.g. people who hold the conviction that "paying taxes is wrong"), simply pointing out the norm will have no, or often a detrimental effect. In such cases the revenue body could focus on related strong basic values, other personal norms, attitudes, or icons. The revenue body could try to activate such a value, norm, attitude, or icon, and then link it to paying taxes (e.g. "by paying tax we take care of the weak", "our national health care saves lives, it is paid for with your tax money", or "our national hero says: we should all pay our taxes").

79. Social norms are generally easier to influence than personal norms. Very often social norms are more negative than reality allows them to be. That is, more tax payers think it is important to pay taxes and do pay their taxes, than people believe is the case. A number of studies from different countries show that people tend to believe that tax evasion is more widely spread than it is. There are several reasons for this phenomenon. One reason is that it is impossible for people to know the exact extent of tax evasion and they tend to think that other people are more dishonest than they are themselves. Another important reason is that the media, often based on information they receive from the revenue body, portray an unrealistic dim view of tax compliance. Simply correcting this inaccurate notion, based on facts or (independent) research, may help to fruitfully promote compliance.
80. When promoting compliance through social norms, revenue bodies could try to predominantly communicate about honest taxpayers and put the message across that this is the norm. People tend to do both what other similar to themselves (part of the same social group) do and what the majority is doing (many others). The influence from "similar others" seem to be particular strong (Cialdini 2009). This implies that messages on social norms should be tailor-made for different target groups.
81. Very often revenue bodies deliver the opposite message: fraud is widespread or many fraudsters were caught by the revenue body. Such communication will evoke the feeling that most people do not comply and will consequently undermine compliance. Communicating that the vast majority of taxpayers comply is in most cases much closer to the truth and also more effective in promoting further compliance. To complete the story, the revenue body could proceed by mentioning that the minority that does evade taxes has been dealt with, thus emphasising that non-compliance is unacceptable. Box 7, on the Australian cash economy, gives an example of how shared social norms on unacceptable behaviour could be used to further tax morale and compliance.

Box 7. Norms—Australian research concerning participation in the cash economy

Existing Australian research (quantitative in design) raised questions around what was driving negative and positive community attitudes (social norms) concerned with avoiding transactions in cash economy. Next (qualitative) research focussed on uncovering the core drivers of community attitudes and how to positively influence them into the future.

The results suggested that it could take a number of years to shift community attitudes concerned with the cash economy. However, a starting point could be to focus upon negative issues/examples relating to the cash economy which people agree with, where the vast majority will acknowledge that such behaviour is 'wrong'. Then, over time, this base of accepted negative associations needs to be expanded so that more and more examples of cash economy transactions are acknowledged as inappropriate.

82. Sending contradicting messages makes it impossible to predict the impact on behaviour. This is not to suggest that the revenue body should hide the true extent of tax evasion. The extent of tax evasion should not be exaggerated but not be down played either. Trust in the revenue body is important in order to convey any type of message and trust can only be built in the long run by consistently being truthful.
83. Measuring compliance attitudes through quantitative surveys can be of great interest and the result can be communicated as a way of influencing social norms. Because of different reasons - such as social desirability - self reported norms, attitudes and behaviour are not necessarily the same as the actual norms, attitudes and behaviour, one should always be careful when it comes to the interpretation of the results.
84. Segmentation by using questionnaires is useful on a strategic level to simplify the complex real world by grouping taxpayers together that have some relevant characteristics in common. But it is at the same time important to remember that it is a simplification and that segmentation should not be taken too far. At an operational level, the dealings with an

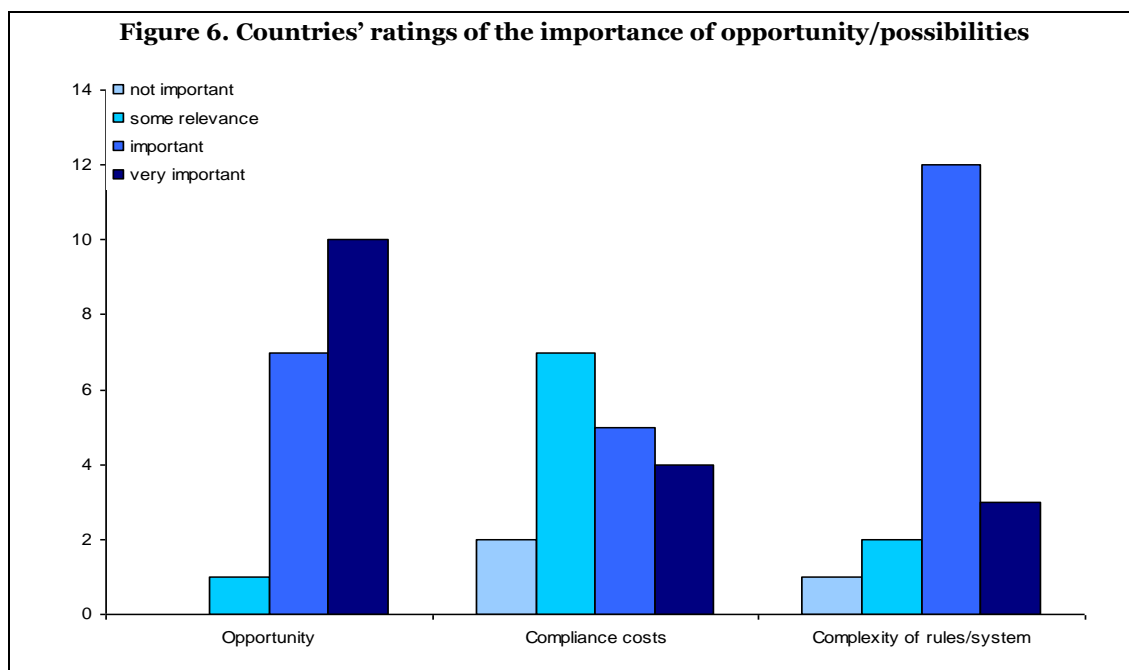
individual taxpayer should be based on that individual's characteristics and circumstances, not on a simplified label.

Opportunities

85. Opportunities for tax non-compliance emerge as an important determinant of tax evasion or tax avoidance in a large number of studies (Antonides & Robben, 1995). Groups of taxpayers differ in (objective and perceived) opportunities to evade or avoid taxes. When taxes are not paid at source, opportunities to evade are higher. Entrepreneurs generally have more opportunities to evade taxes than private taxpayers, because they are more active in the cash economy (see Kirchler, 2007).
86. Opportunity to comply is equally important. It should of course be possible to fully comply with all requirements. The ease of complying plays a crucial role. Since tax law is complex, it should be made very clear what is expected of people and very easy for them to act accordingly. Compliance costs, monetary and in terms of time and effort, can create barriers for tax compliance.
87. Research also points to the aspect of behavioural control. Not only are the actual or objective opportunities important for compliance behaviour, but also the perception of opportunities. Taxpayers generally have a limited understanding of tax laws, so it is likely that the average taxpayer does not know how to evade or avoid taxes. This also could mean that sometimes it is difficult for taxpayers to comply with tax laws. If taxpayers feel that the behaviour it not fully under their own control, it is extremely difficult to comply.

Practical implications and examples

88. Figure 6 shows the importance of opportunities as indicated by the participating countries. Almost all countries perceive opportunities, and to a somewhat lesser extent, complexity of rules and the system as (very) important in stimulating compliance. About half the countries rate compliance costs as (very) important.



89. The practical implications rest in reducing the opportunities for evasion and increasing opportunities for compliance. The harder it is to commit fraud or make mistakes and the easier it is to comply, the more people obey the law. Reducing opportunities for evasion is equally important as providing good opportunities for compliance. This does not only go for actual opportunities, but also for the perceived ones. Hence, if people think it is extremely easy to comply and impossible to commit fraud they won't even start trying to evade taxes, and visa versa. In their pursuit for compliance revenue bodies should constantly focus on influencing actual and perceived opportunities.
90. The most common example of limiting opportunities for evasion and mistakes is to introduce third party reporting with or without a tax withholding regime. Third party reporting can be used for pre-filing tax returns. This will limit opportunities for evasion and mistakes even more while at the same time constituting a service for the compliant taxpayer. It makes it very easy for the taxpayer to do the right thing.
91. The notion that people are "cognitive misers"¹ underlies the idea that opportunities influence compliance. From this perspective taxpayers might be characterised as "lazy non-compliant" or as "lazy compliant" (this does not mean in any way that they are lazy as persons, it only describes their position or attitudes towards the effort of being compliant). If taxpayers want to comply but find it too much work and hassle to obey the law, they might be tempted to settle for a good enough approach, taking shortcuts and trying to comply by approximation. They are aware that they probably have made some mistakes but they don't bother or lack time or interest to find out which mistakes, leave alone correcting them. The lazy non-compliant would comply totally if only it had been easy. Other taxpayers might not object to becoming rich through fraud, but find it too much bother to find out how and work out a successful scheme. Such taxpayers could be characterised as the lazy compliant. Making it difficult to evade and making it easy to comply would keep both types of cognitive misers compliant.
92. Revenue bodies traditionally focus on making it hard to evade. They normally do this by getting laws repaired when they are being evaded, making it harder to evade, and by communicating the impression that their information position (e.g. through third party reporting) allows them to detect most forms of evasion in the long run. Also encouraging electronic payments, thus reducing the amount of (risky) cash transactions, or requiring technically fraud preventive pay-desks, can be seen as measures that make it difficult to evade taxes.
93. Other avenues for making it easy to comply are communicating in plain (non legal) language, easy accessible websites, easy tax forms, more automatic tax, accessibility of personal relevant information, and simplification of the tax system and reduction of rules. Box 8, which provides a brief description of the use by a Swedish regional revenue body of information letters sent to taxpayers prior to the filing of tax returns, gives an example how a revenue body can promote compliance by making it simpler for taxpayers to comply.

¹ "Cognitive misers" is a term which refers to the idea that only a small amount of information is actively perceived by individuals when making decisions, and many cognitive shortcuts (such as drawing on prior information and knowledge) are used instead to attend to relevant information and arrive at a decision.

Box 8. Opportunities—Sweden's' use of information letters sent to selected taxpayers prior to filing tax returns

In connection with the 2001 tax assessment, the revenue body in The Swedish region of Gävle sent out an information letter to a group of self-employed persons who were required to reverse tax allocation reserves for taxation. The letter was sent out prior to the date for filing tax returns. The letter was personal and each recipient was told how large an amount had to be reversed. A control group was employed which received no information. Both groups were then checked and it was measured how many taxpayers had reversed their tax allocation reserve correctly.

The group of taxpayers who received a personal letter did the right thing to a considerably greater degree (96%) than those taxpayers who had received others (80%).

94. Offering an easy route to compliance may not only work for cognitive misers. Taxpayers sometimes feel they have to struggle really hard to do the right thing. Some can feel obstructed by complex tax laws and unclear tax forms, by a website that is down and if operational forms a perplexing labyrinth of intangible web pages, by a telephone number that is perpetually engaged, and by unaccommodating tax officers who are more than willing to explain why they are too busy to assist. Confronted with so much hindrance, taxpayers may feel insecure if they have actually met all the requirements, feel that their efforts are not acknowledged, feel they are treated unjustly, and ultimately may lose their intrinsic motivation to comply now and in the future.
95. Mistakes made by taxpayers are an important category of non-compliance. Mistakes can arise from simple arithmetical or transcription errors. But they can also arise as a result of what you can call 'a failure to take care' - for example in record keeping. Understanding the causes of mistakes can provide practical opportunities to redesign processes and to refine education and guidance. Ideally the type of understanding required goes beyond analysis of the mistakes taxpayers make from a revenue body perspective and would include in-depth understanding of how businesses operate the pressures they face and the processes they use and finding effective means of communicating with businesses in a way that will engage sympathetic attention. Box 9, describing anthropological research carried out on behalf of the UK HMRC's to better understand the factors that motivate compliance, gives an example of this.

Box 9. Opportunities—UK HMRC's anthropological² research on motivating compliance

This research was conducted in 2008 to help understand how and why SME customers use HMRC's tax products. The aim was to explore the deeper motivation behind small businesses compliance with tax regulations. In a private sector context this would be 'closing the deal' and post sale customer service. In a tax context it is getting the tax in and keeping the business motivated to repeat the experience next time round. In essence the emotional and non-rational dynamics that motivate small businesses in the UK were explored to see whether HMRC could piggy back on those to drive better voluntary compliance.

The research was built around ethnographical³ work with 16 representative small businesses supplemented by 16 focus groups. To do the ethnography a specialist anthropologist and ethnographical researcher were used to study SME's in their native environment and explore how their day to day work and attitudes impact on their tax compliance. The research took six months from start to finish and gave a series of pointers as to how compliance can be improved, for example:

- Tax is seen as complicated; many SME's have poor tax habits, thereby driving an over-reliance on accountants.
- The tax authorities are feared. Fear reinforces a lack of engagement, which combined with tax being dull and complicated means that many sources of help are under-utilised.
- Most small businesses work to a steady rhythm of orders, customer interactions, deliveries and sales. Tax does not fit into this natural rhythm – it often has compliance dates far into the future. This, combined with the points above, enables businesses to put off dealing with their tax affairs.
- Small businesses believe in the principle of fair exchange, be this either goods for services or as customer satisfaction. Whilst small business owners often see what they get for the tax that they pay as an individual, they do not see that their business gets any return on the tax that it pays. Tax compliance is seen as an activity for which SME's get no return.
- Since small businesses interact with HMRC on a one to one basis dealing with one's tax is an individual rather than a social task. This isolation means that SME's cannot learn from the good practice of other SME's and complying with one's tax obligations is not a social activity as most other things are.

The findings of this research will enable HMRC to shape its products and processes so that they work with the grain of small business rather than against it. Improving the design of tax products and the delivery of services will in turn improve the SME customer experience and ultimately their compliance. Also important has been the creation of DVD's that are used in training sessions with staff to enhance their understanding of the pressures faced by small businesses.

Fairness and trust

96. Fairness and trust are perceived by many researchers to be important drivers for compliance. Valerie Braithwaite points out the importance of mutual trust and cooperation between the taxpayers and their tax authority in order to achieve voluntary compliance (Braithwaite, 2008). Kirchler and Hoelzl (2006) argue that fair treatment of taxpayers and trustworthiness of tax authorities will enhance voluntary compliance.
97. Murphy (2004) shows in a study of accused tax avoiders that there is a correlation between fair and correct treatment of the taxpayer and trust in the revenue body. Trust is in turn correlated to the willingness to comply. If regulators are seen to be acting fairly, people will trust the motives of that authority, and will defer to their decisions voluntarily. Fairness and trust are thus interlinked and the one cannot exist without the other.

² Anthropological – related to the scientific study of people, society, and culture.

³ Ethnographical – related to a methodological strategy used to provide descriptions of human societies.

98. Fairness and trust therefore also provide an explanation about why most people comply with tax laws and why some are motivated to evade taxes. Generally a positive effect of perceived fairness in tax related affairs is found, meaning that perceived fairness will strengthen tax compliance.⁴
99. A distinction can be made between different types of fairness. *Distributive* fairness concerns considerations related to outcomes or the exchange of resources (how taxes are paid and spent). *Procedural* fairness relates to perceptions about the procedures, i.e. how the system works and how the dealings with the revenue body work (e.g. handling of different cases). *Retributive* fairness concerns the appropriateness of sanctions when rules or norms are violated.
100. Perceptions of distributive fairness have been shown to affect tax compliance (for an overview see Wenzel, 2003 and Kirchler, 2007). People who experience their tax burden to be higher than others tend to be less compliant with tax laws (e.g. Kinsey, Grasmick & Smith, 1991). Likewise, the more people believe that the government takes good care of their paid taxes and spends it carefully, the more compliant they tend to be.
101. Studies suggest that procedural fairness influences the acceptance of decisions made by the tax authority and builds trust in the tax authority among private taxpayers (Braithwaite, 2003; Murphy, 2004). Procedural fairness is important for tax authorities, since by enacting fair procedures authorities support their legitimacy and trust (Tyler, 1997; 2006). Kirchler, Niemirowski and Wearing (2006) found that perceived supportiveness of advice by tax officers was associated with self-reported compliance and studies by Pommerehne and Frey (1992) and Torgler (2005) show that “if taxpayers have a say in political decisions with regard to financial issues” tax morale is stronger.
102. According to Leventhal (1980) procedures are considered as fair if the following criteria are met: procedures should be consistent, accurate, free of errors, representative, ethical, and correctable. Tyler and Lind (1992) add other criteria to the procedural fairness concept, such as respectful treatment by authorities, voice and neutrality. Perceptions of procedural fairness are influenced by complexity of tax laws and non-transparency (Carnes & Cuccia, 1996), and by the efficiency of information desks, and a respectful and professional audit treatment (Wallschutzky, 1984).
103. The perception of fairness depends thus to a great extent on how the citizens perceive the authority's actions. A taxpayer may perceive an authority as just and fair even if it has made a decision that goes against him, if the authority acted in a good manner. This leads in turn to fewer complaints about the authority's decisions. What is important is not, therefore, whether the outcome is positive or negative, but whether it is fair (Wenzel 2002). If an authority treats an individual courteously, it shows respect for the individual and helps increase the perception of fairness (Murphy 2003).
104. According to Valerie Braithwaite (2008) the important message from this research is “...that authorities develop trust and build their legitimacy, not through giving people the outcomes they want, which is often impossible, but rather through observing their right to a fair hearing and respectful treatment.” Studies show that the perception of procedural fairness is linked both to the acceptance of a specific decision and to the inclination to comply with laws and rules more generally (Tyler 2001).
105. People are in general very sensitive to perceived injustice. Being treated fair and with respect can be more important than pure economical interest. A non-tax study on car dealers in USA

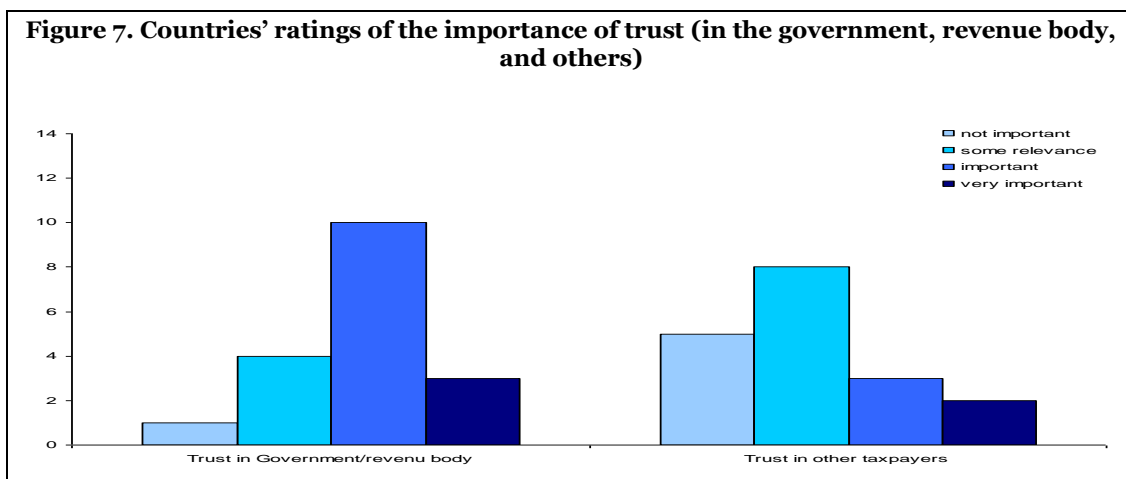
⁴ See Kirchler (2007) for a recent overview of the empirical studies of fairness in relation to tax compliance.

illustrates this clearly. The car dealers should from an economical point of view focus only on prices and margins when they are dealing with the car manufacturers. A survey showed however that the dealers evaluated their transactions by such seemingly insignificant details as whether the manufacturers “took pains to learn the local conditions under which dealers operate, acted in a polite and well-mannered fashion and treated dealers with respect”. These fairness factors proved more important than the economical outcome of the transactions (Brafman and Brafman, 2009). When procedures are perceived as fair, so will the outcome.

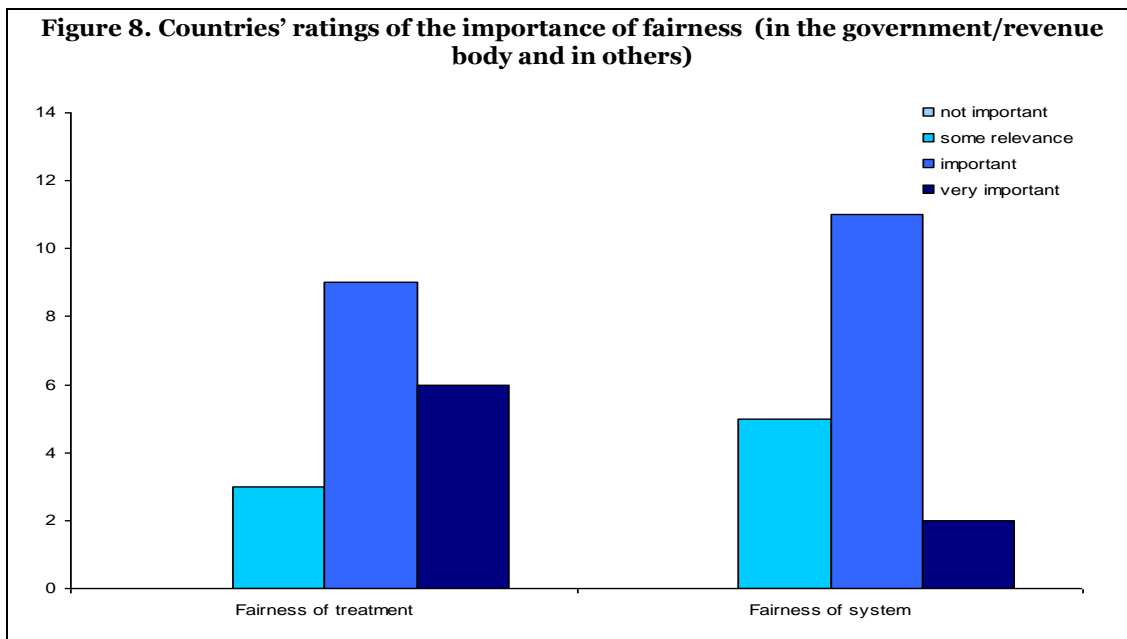
- 106. Retributive justice refers to the perceptions of fairness of sanctions when rules are broken (Tyler, 1990). Perceptions of retributive unfairness may occur when sanctions are too severe, or too mild. Studies by Strümpel (1969) and Spicer and Lundstedt (1976) show that unfair penalties and aggressive tax audits can lead to negative attitudes towards the revenue body and towards paying taxes. Although retributive fairness can be important for tax compliance, because it also relates to the legitimacy of the authorities, it has not received much attention from researchers.
- 107. It is clear that fairness and trust are important drivers for compliance. Of special interest for revenue bodies are the importance of procedural justice and its importance for building trust and in that way support voluntary compliance. This means that it is not only important *what* a revenue body does; it is also important *how* the revenue body does it.

Practical implications and examples

- 108. Figure 7 presents the ratings of the participating countries of the importance of trust in the government or the revenue body and of the trust in other taxpayers in enhancing compliance. A majority of the countries state that trust in the government or the revenue body is important for stimulating compliance. Remarkably fewer countries underline the importance of the influence on compliance of trust in other taxpayers.



- 109. The reported importance of fairness for compliance is presented in Figure 8. Both fairness of the system and, in particular, fairness of treatment are seen by a majority of revenue bodies as (very) important drivers of compliance.



110. Fairness is multifaceted and is connected to trust and both concepts are relevant for compliance. In order to promote compliance through fairness the distribution ought to be even-handed, the procedures must be fair and the sanctions for evasion should be appropriate. From both an ethical and a practical point of view all revenue bodies should strive to maintain the highest possible standards of fairness. Taxpayers generally mention fairness as an important factor when talking about taxes. Box 10, describing research carried out by Singapore's Inland Revenue Authority (IRAS), shows that retributive fairness (perception of revenue body's effectiveness in dealing with non-compliance) and fairness and integrity of the revenue body are found to be the strongest correlates of strong social norms. Box 11 shows that procedural justice may contribute to audit satisfaction, based on research carried out by Chile's Internal Revenue Service (IRS).

Box 10. Fairness—IRAS's survey of taxpayers' perceptions concerning compliance

Quantitative research was conducted in by the IRAS in the form of mailer surveys of taxpayers and tax agents. Some 16,409 forms were sent to selected taxpayers, and the total number of respondents was 4,710 (29%).

Based on regression analysis, it was found from the survey results that four criteria were directly and significantly related to the perception of the general level of compliance. These variables, in order of their perceived impact, were:

- Perception of IRAS' effectiveness in dealing with non-compliance,
- Perception of fairness and integrity of IRAS,
- Attitude towards compliance; and
- Compliance costs.

Box 11. Fairness—Chile IRS's research of taxpayers' satisfaction with tax audit procedures

Nine hundred and nine companies and individuals that had been audited in the past two years were interviewed in Chile. The study focused on determinants of satisfaction with field audits.

The results indicate that concerns about the procedures relate to audit dissatisfaction. Such concerns are: Number of required visits to the offices of the Revenue Body is excessive; audit process isn't well understood; taxpayers don't know their rights; the documentation isn't returned on time to taxpayers; and assignment of a new auditor during the procedure.

111. Directly promoting distributive fairness seems problematic for most revenue bodies. How tax burdens and common goods are divided among individuals and groups within the population is generally beyond their influence and usually a result of political debate. Revenue bodies are generally, and for good reasons, reluctant to get mixed up in that arena. This does not imply that revenue bodies should turn away from distributive fairness perceptions as an important health-of-system indicator. Revenue bodies can keep themselves informed on the state and development of feelings of distributive fairness among the population and inform the policy makers as well as use it as a risk indicator.
112. The revenue body is the principal player when it comes to influencing perceptions of procedural or retributive fairness. Especially for promoting feelings of procedural fairness, the literature provides a rich list of practical and modifiable variables: such as being consistent, neutral and accurate; treating taxpayers with empathy and respect, and giving them voice and the opportunity to correct mistakes made by the revenue body. Such variables may seem simple and logical, but can in practice prove hard to act out. In order to really promote feelings of procedural fairness, and in doing so bolstering trust and compliance, revenue bodies could actively monitor the influence of their actions on this type of fairness. This monitoring can be conducted on an aggregate level, for instance by means of questionnaires. More effectively in the light of internal behavioural change, auditors could themselves ask the tax payer about their opinion on the audit and how it was performed.
113. The current knowledge on retributive fairness is relatively scarce. Insufficient to draw practical implications. In so far theorists or researchers have given the topic attention, they have mainly focussed on perceptions of the fairness of the severity of punishment after evasion. Brutal treatment and severe penalties appear to hamper feelings of justice and may be detrimental for compliance (Spicer & Lundstedt, 1976).

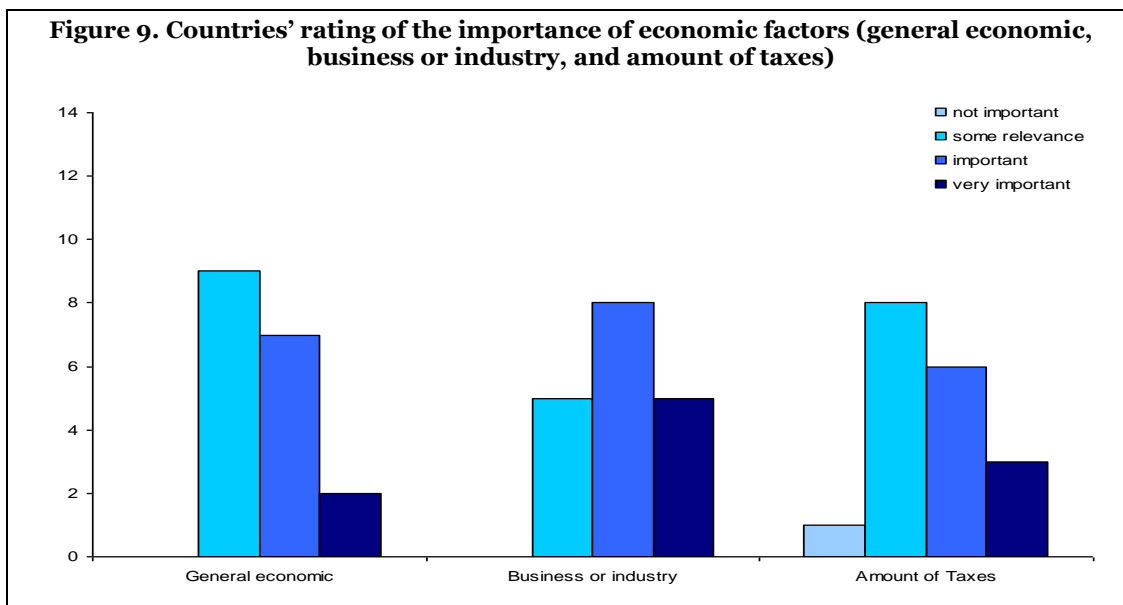
Economic factors

114. Economic factors can be motivational factors and situational factors and can in both capacities influence compliance behaviour. In the context of tax compliance there is, however, a lack of research linking economic factors to compliance behaviour. The only economic factor that has received a lot of attention is the amount of taxes to be paid or the tax rate. And, as was mentioned earlier, studies examining these relationships yielded inconsistent results.
115. Loss aversion that has been described earlier is of great importance when it comes to economical factors. Taxpayers are willing to take big risks in order to avoid losses. This is particular important when a taxpayer faces the risk of loosing his business and lifework. A person normally not willing to evade tax can under these circumstances take the step and become non-compliant in a desperate attempt to save his business. A Swedish study (National council for crime prevention, 1996) describes the average convicted economical criminal in the following way "The average economic criminal is a man in his forties. He owns a small business. He either has no previous criminal convictions or has had legal proceedings commenced against him on only very rare occasions. He grew up and lives in settled social circumstances, but has financial problems."
116. Liquidity problems can trigger tax evasion. Liquidity problems are also often associated with poor knowledge of accounting and finance which is more common in small businesses (Webley, 2002). The size of the business and standard of accounts can thus have an impact on compliance behaviour. Maintaining accurate business records can be helpful to business productivity: the business can measure its profits accurately, keep track of wages paid out, plan production activities, obtain access to financial sector services, formal insurance, etc. Realistically, the productivity gain of keeping business records is larger when the business is larger and more complex, and for modern businesses the cost of being of-the-books becomes prohibitive (Kleven, Kreiner & Saez,

- 2009). Often it is in the business' own interest to keep good books and track of the economical situation. Tax evasion would then require duplicate books and increased costs which can serve as a disincentive for non-compliance. There is also risk that employees for some reason act as a whistle-blower and reports non-compliant behaviour to the revenue body.
117. A study commissioned by the Swedish Tax Agency (2009) shows that self-reported compliance is much higher for businesses with employees than businesses without employees. This is of particular interest since the same study showed that businesses with employees were less happy with both the tax system and the tax agency.
118. Another issue is whether a higher rate of unemployment leads to a larger unofficial economy. Will unemployed people find work in the informal sector and thus evade more tax? Studies in UK (Pahl, 1987) and Sweden (Swedish National Audit Office, 1998) indicate that the unemployed are underrepresented in the informal sector. People that tend to do well in the formal sector are the same people that are doing well in the informal sector and vice versa. But this is not necessarily true for countries with a large unofficial economy where "envelope wages" outside the books are the normal routine rather than the exception.
119. Economic factors are also shown to be important on a macro level. There exists a correlation between the level of tax evasion and economic growth. Johnson, Kaufmann, and Zoido-Lobaton (1999) found, using data set of 49 Latin American, OECD, and transition economies, evidence suggesting that a lower unofficial economy is significantly associated with higher rates of GDP growth. The formal economy is more efficient than the informal economy. They also found that it is the ineffective and discretionary application of regulatory and tax regimes in many countries, and not tax rates alone, that increase the size of the unofficial economy. Economic growth seems to be a factor that reduces tax evasion at the same time as low level of tax evasion is positive for economic growth.
120. Of interest is also the fact that there is a correlation both between tax evasion and corruption (Tedds, 2007) and between corruption and economic growth. Increases in GDP per capita are found to lead to a long-term reduction in corruption. But economic growth increases corruption in the short-term (Brown & Schackman, 2007). These findings suggest the possibilities that economic growth can reduce tax evasion in the long run but increase tax evasion in the short run.
121. Economic factors play a role in tax compliance. A general conclusion is that factors that are positive for economic growth also tend to promote tax compliance.

Practical implications and examples

122. Figure 9 presents the reported importance of economic factors in stimulating compliance. About half of the countries perceive general economic factors and the tax burden as important in predicting compliance. A majority of the countries indicate that factors related to the business or industry are important for compliance.



123. Economic factors comprise of an astonishing amount of different very tangible variables that are in one way or another related to compliance. The great advantage of these factors over other factors is that they are very concrete and generally easy to measure. Disadvantages of these factors are that they are generally difficult to manipulate and need other factors to explain why they influence compliance. Three examples are given to demonstrate this. In Box 12, findings from Norway's Fair Tax Evasion project research suggest that low wages and long working hours are related to non-compliant intentions. This relationship might be mediated by considerations of fairness. In Box 13, describing research carried out by the Canada Revenue Agency (CRA) involving younger Canadian citizens, the findings suggest that awareness that the revenue body may pay back money motivates younger taxpayers to file a return. In Box 14, an account is provided of New Zealand research which suggests that geographical-related variables may explain regional differences in compliance by business/industry.

Box 12. Economic factors—Learnings from Norway's Fair Tax Evasion Project

A sample of 532 individuals from the Norwegian "Hidden Labor Market Survey" answered the question: Can tax evasion be justified? A series of simple (probit) regression analysis revealed that personal economic factors, low wages and long working hours, were related to the probability of justifying tax evasion and to the willingness to take home income without reporting it to the tax authorities.

Box 13. Economic factors— Learnings from CRA research involving younger citizens

The CRA was interested in better understanding youth's levels of awareness about and attitudes towards taxation, and to identify any knowledge gaps relative to the subject. In addition, the CRA wanted to gain insight into potentially key messages that resonate with this segment of the population and the best vehicles for conveying taxation information to it. This study was conducted with youth aged 16 to 22 years old. To meet the research objectives, a total of twelve focus groups were conducted.

Findings suggested that youth have minimal awareness and understanding of income tax-related terminology. Youth also expressed limited knowledge of the requirements and processes involved in filing an income tax return. The findings highlighted the importance of informing and reassuring youth. Most importantly, youth need to be aware that they could potentially get overpaid tax refunded if they file a return, as it was deemed the greatest motivator. Parents, the Internet and the telephone were considered the most useful means of accessing governmental information, while in-school presentations and print advertisement were deemed the most effective means of communicating simple tax information to youth.

Box 14. Economic factors—NZ IRD's research into the relevance of geographical location

The New Zealand Revenue Body set out to investigate differences in taxpayers' filing and payment behaviour related to their geographical location within New Zealand and to analyse the rationale behind any differences. A geographical comparison was made on the basis of internal data (customer business demographics, customer entity types, tax information, and on time filing and payment compliant behaviour) and external data (urbanisation and industrial sectors). In order to better explain any geographic differences analysis were conducted using customer demographics (industry groupings, number of employees, turnover, business age), tax information (tax types – INC, PAYE, GST, FBT), compliance (filing and payment non-compliant behaviour), entity types (companies, partnerships, individuals, societies, trusts).

The results showed Auckland consistently to have lowest levels of compliance, and the South Island the highest levels of compliance.

- The 'Auckland effect' most frequent for turnover-based groups, followed by employee-based, business age and industry groups; found least often for entity type-based groups.
- Partnerships and trusts had the highest levels of compliance; business (self-employed) individuals were the least compliant. Individuals are the group most affected by geographical location, while partnerships are the least affected.

Interactions

124. Research shows that specific combinations of the drivers mentioned in previous sections can have effects on compliance behaviour up and above the individual effect of one of the drivers. As a result, in recent years the attention given in research to the effect of specific combinations of motives is growing. Importantly, results indicate that motives can undermine each other in their effect on compliance behaviour. An example is that from a high level of perceived deterrence people can infer that non-compliance is the (social) norm.
125. A willingness to comply can be undermined by an external incentive (like a threat of punishment for non-compliance). External incentive can also strengthen a person's own personal motivation if the individual perceive the interventions to be supportive.
126. Deterrence in the absence of both social and personal norm will have to be very strong in order to work (and thus running the risk of further preventing norms to be fostered). It is therefore essential to use deterrence and interventions as a way of creating or supporting social norms.
127. Another prerequisite for a supportive intervention is that it must be perceived as fair and is characterised by procedural fairness. This shows that deterrence, norms and fairness are interlinked and that they cannot be treated and used as separate drivers behind behaviour. The different factors influence each other and the best effect on compliance is achieved when they are working aligned and in support of each other.
128. Deterrence works better than no incentives at all. But personal norms and social norms are far more influential than deterrent factors. Moreover, deterrence usually impacts a specific act or decision, while personal norms guide behaviour on a more general level. Social norms can both influence personal norms and can lead to high social costs for non-compliance, making it a very strong incentive for honest behaviour. Norms can be maintained and strengthened by a deterrent component applied in the right way, thus creating an even stronger incentive for compliant behaviour. Deterrence is therefore a powerful tool for supporting or strengthening norms. Deterrence can, however, also destroy norms if used in the wrong way. The actions of the revenue body (deterrent or others) will be more effective if interventions or treatments are

perceived as procedurally fair and if there exists a high level of mutual trust between the revenue body and taxpayers.

129. Reducing opportunities for tax evasion and increasing opportunities for compliance works well together with deterrence and norms as long as such regimes are perceived to be legitimate and associated with high levels of procedural fairness. Limiting opportunities for non-compliance too much brings the same risk as deterrence and can crowd-out internal motivation to comply. Forced compliance, either through deterrence or no opportunities for evasion can reduce the willingness to comply and thus make the whole system less legitimate and create incentives for defiant behaviour.
130. This gives a simplified description of how different factors influence behaviour. In reality human behaviour is very complex and is shaped by individual characteristics and the social environment. Taxpayers differ in both their capabilities and motives to comply and situations and circumstances. This implies that it is too simplistic to divide the taxpayer population into compliers and non-compliers. Taxpayers can be found on a continuum from total compliance to total non-compliance. The individual's position on this continuum is not fixed— it changes depending on both the individual and the situation or circumstances. Nevertheless, knowledge and understanding of compliance behaviour can take the revenue body a long way towards becoming a more efficient and effective tax administration.

Practical implications and examples

131. Enforcing effectively is an extremely complex task. Deterrence may counteract the positive effects of personal norms, but when personal norms are weak, deterrence may strengthen them. In some cases deterrence seems to undermine the compliance enhancing effects of social norms, and in other cases deterrence strengthens them. An example of both of these last two effects can be found in Box 15 which describes findings of research carried out by the Netherlands Tax and Customs concerning attitudes and intentions on moonlighting. Another example of the interaction between deterrence and fairness can be found in Box 16 which draws on the findings of a UK HMRC study and which shows the importance of fairness for the acceptance of their penalty system.

Box 15. Interaction—Netherlands' research on attitudes and intentions to moonlighting

An experiment was conducted among 114 students to determine the combined effect of threatening and normative messages in the media on compliance. The participants first read one of four articles on moonlighting —working “off the books” without paying any tax and other charges due. In all four conditions, the article first contained a brief introduction to a voluntary disclosure scheme: *“The Tax and Customs Administration is launching a voluntary disclosure scheme for moonlighting students. Students who declare their previously-undeclared earnings under the scheme can escape a fine”*. The article continued with a threatening message (weak or strong) and a normative message (non-compliant or compliant). The participants then answered questions on their attitudes and intentions concerning moonlighting and voluntary disclosure.

The results of the study show that normative messages have a strong positive effect on compliance (combined: negative towards moonlighting and positive towards voluntary disclosure), whereas threatening messages have no direct effect. This does not mean that messages containing a threat are ineffective: respondents had the least positive attitude towards working without paying the tax and other charges due (hereinafter referred to as moonlighting), and the least inclination to do so, after they had read an article that contained both a message about compliant norms of behaviour and a strongly threatening message.

On the other hand, their attitude to taking advantage of a voluntary disclosure scheme was most positive, and their inclination to actually do so strongest, when they were presented with a message about compliant norms alongside a message that contained a low level of threat. The strong influence of the compliant normative message on making use of the voluntary disclosure scheme was suppressed by a threatening message.

Box 16. Interaction—UK HMRC's study on customer views of the new penalties regime

In 2009, HMRC introduced a new penalties regime operating across all taxes. The penalties regime is behaviourally based and includes an offence of 'failure to take reasonable care'. Failure to take reasonable care is not well defined by legislation so HMRC needed to explore what was meant by this. To do this, HMRC employed an external market research agency to carry out in-depth qualitative research with customers with the aim of ascertaining what the customer thinks of "taking reasonable care" in relation to their tax affairs.

The study concluded that, overall, there is consistency and agreement among customers about their obligation to a minimum standard of 'reasonable care' and appreciation of a system that clearly defines compliance, and offers consequences through an intelligent penalty. However fairness is critical to successful working and for the system to be workable, there needs to be some in-built 'response-ability' from HMRC. For example the following elements are considered likely to deliver to requirements:

- Yellow Card system for first time mistakes;
- Discretionary 'let off' for proven exceptional circumstances (illness, bereavement, emergency);
- Acceptability of delegating ability to a paid professional (responsibility for error to rest with them if tax payer has responded to all appropriate requests); and
- Acceptability of a 95% rule (N.B. 'Should be' less for turnover over a certain amount and bigger businesses).

132. One lesson learned is that behaviour needs to be influenced in different ways depending on the context. It is always good to foster social and personal norms in favour of tax compliance. But if there are no norms in favour of compliance, deterrence can work in the short run. But in the long run, a high level of voluntary compliance can only be achieved by establishing norms in favour of compliance. This in turn can only be achieved if the tax system and tax administration are perceived as just and fair regarding both procedures and outcome. The example in Box 17, drawn from research carried out by the CRA, suggests a hybrid approach to advertisements concerned with tax compliance, entailing both normative appeals and deterrent messages.

Box 17. Combined factors—The CRA's campaign-related research

Focus groups in Canada discussed what types of broad themes would be most successful for a tax compliance campaign in persuading various target audiences that non-compliance is not a desirable behaviour. Further, the groups explored where, when, and using what medium would make this type of communication most effective in persuading the audiences that they should comply with their tax obligations.

Results showed that it is important for examples to be real and tangible; participants reacted poorly to the use of statistical information on its own. Results further showed that it is important to dispel the notion that tax avoidance is something that only wealthy people get caught for and underline the fact that "ordinary" people are also caught. Two key conclusions emerged from the results: messages about what taxes pay for are appealing, but guilt is not seen as an effective motivator; and, messages about the consequences of avoiding taxes are seen as distasteful, but compelling. A hybrid approach to advertising that includes both messages is recommended for development.

133. That it is difficult to effectively influence behaviour is well established. Actions seldom only touch on one driver. Much more often they resonate with deterrence, norms, opportunities, fairness and many other factors, probably resulting in unpredictable outcomes. More knowledge on compliance behaviour can be useful to gain more insight on improving compliance. In any tax situation, it can't be stated with certainty that all the important drivers have been identified. The example in Box 18, which draws on research carried out by the Danish revenue body (SKAT) into the tax compliance dilemma of Danish housecleaners, illustrates that tax-related considerations may not always dominate the decision to comply with, or evade, tax-related responsibilities .

Box 18. Combined factors—Danish research concerning participation in “black economy” transactions.

A qualitative study from an anthropological perspective was conducted among citizens with experience relating to “black economy” cleaning of private households. The 20 semi-structured interviews included a card-playing exercise to open up for conversation on controversial subjects, and focused both on the compliance dilemma in question and on broader compliance dilemmas.

Among the key findings is that a surprising amount of practical, economical and moral considerations – among which tax considerations are in no way paramount – enter the equation when interviewees confront a compliance dilemma such as the decision of whether or not to engage in a “black economy” transaction.

134. But the body of research on compliance and its drivers is steadily growing. Every time a revenue body invests in research on the effects of their actions on compliance, and subsequently decides, even if the results are not positive, to share this knowledge, another little piece of the puzzle is revealed. Already some pieces seem to have fallen into place. It remains important to gather more knowledge on compliance and its drivers and how different types of treatment impact them. The complexity in understanding taxpayer behaviour can appear overwhelming and subsequently this kind of knowledge can seem hard to obtain and apply for the revenue bodies. If, however, the revenue body takes point of departure in trying to understand the taxpayer's perspective, the complexity will often be less difficult to grasp and the compliance treatment opportunities will often show themselves more clearly.

III. Conclusions

135. As gathered from the discussion above, a better understanding of the drivers of taxpayer behaviour will allow revenue bodies to identify and implement more effective approaches to increase compliance.
136. Based on the research contained in this note, it is possible to conclude that a number of practical actions could be considered:
 - Effective compliance strategies and treatments aim to impact the main motives or drivers underlying compliance behaviour. Treatments and interventions should fit the specific circumstances and drivers of individuals, groups or businesses.
 - Circumstances and drivers change and it is too simplistic to divide the taxpayer population into just compliers and non-compliers. Taxpayers can be found on a continuum from total compliance to total non-compliance. The individual's position on this continuum is not fixed— it changes depending on both the individual and the situation or circumstances.
 - The research discussed in this information note shows that taxpayers' compliance behaviour has different motives and drivers and that there are different routes to compliance behaviour. In some circumstances audits might be considered to improve compliance (and follow-up audits where intentional non-compliance was initially found) to reinforce the notion that a change in behaviour is required. In order to work, this strategy needs to be communicated with taxpayers.
 - However, the relationship between audits or the threat of audits and compliance is not as simple and straightforward as was assumed earlier. A strategy solely based on deterrence can have major drawbacks and does not necessarily result in improved compliance behaviour and can even result in less compliance. Revenue bodies seem to be aware of the risks of depending solely on a strategy of deterrence and indicate that they consider norms to be the most important driver for taxpayer compliance behaviour. But deterrence used in the right way can be an effective tool for supporting existing social norms in favour of compliance.
 - In order to be aware of personal and societal norms in a jurisdiction, regular public opinion research (obtained through surveys or focus groups) could be undertaken. Analysis of this research provides valuable knowledge to the revenue body and is critical to the development (and possibly the assessment) of a compliance strategy.
 - Public opinion research can detect pockets in society where the perception of unfairness may be widespread. Given that perceived unfairness can lead to non-compliance, the revenue body can react to the perceived unfairness as well as any associated non-compliance. Fairness and trust are important drivers for compliance and can to a great extent be influenced by the way the revenue body treats the taxpayers. Neutrality and respectful treatment are important.
 - It can be important to think about how messages being delivered to taxpayers are perceived. For instance, messages that are perceived as saying that non-compliance is widespread have a significant (negative) impact on those who are compliant. Revenue bodies should ensure that key messages are reviewed, and possibly tested, prior to release.

- Wherever possible, messages should reinforce social norms toward compliance. When misconceptions or inaccuracies regarding compliance are being spread, revenue body could act swiftly to provide factual information to dispel these harmful messages.
 - Establishing and sustaining strong taxpayer norms is the key to attaining high levels of taxpayer compliance. Norms also have the benefit of being relatively inexpensive to maintain once established. To reach this stage, an approach that combines deterrence with normative messaging is seen to be highly effective – more so than one of these two approaches on its own. This allows a revenue body to apply deterrence while using social norms as the rationale/signal to the non-compliant taxpayer that society views such behaviour as unacceptable. Implied with this approach is that the revenue body is simply acting upon society's wishes.
 - Focus on taxpayer behaviour highlights the need to measure outcome and not only rely on traditional output-based performance measures (such as the value of tax adjustments) as they do not provide information about the true state of taxpayer compliance. Output-based measures also inhibit the development and application of strategies aimed at changing taxpayer behaviour. Compliance is most appropriately measured as a trend over multiple periods, requiring greater patience within a revenue body.
 - In order to make it easier to comply, revenue bodies may wish to user-test new and existing forms to ensure higher rates of compliance within the lazy non-complier and unintentional non-complier population. Wherever possible, use plain language and create easy to follow forms.
 - Understanding taxpayer compliance behaviour is not just about non-compliance. It is very much about understanding compliant behaviour and how that behaviour can be reinforced. Promoting compliance also requires an understanding of the role of tax intermediaries and other third parties, they are part of the factors that influence taxpayer behaviour. Revenue bodies need to work in cooperation with other parties in order to be able to effectively influence behaviour.
137. Research on understanding and influencing taxpayer behaviour is a relatively new, and fast growing, field of study. Experts in this area understand that research will be necessary to support all future tax compliance strategies. Therefore, there is a strong mutual benefit to be achieved by working co-operatively and sharing research findings amongst revenue bodies.

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Taxpayer Compliance Behaviour: Summary of Findings from Revenue Body Research

Introduction

138. A questionnaire was sent to member countries as part of the work on taxpayer compliance behaviour. The purpose was to learn more about the research used and carried out by revenue bodies. Nineteen countries responded, of which eighteen returned a completed tax compliance questionnaire. The questionnaire contained questions on the research that has been conducted within the country on the indicators of tax compliance that have been researched, and the presumed influence of these indicators on compliance.

Research conducted or commissioned

139. Of the eighteen participating countries, sixteen conduct or commission research on tax compliance. Fifteen countries state that the research is conducted with the aid of external bodies, like academic institutions or commercial bureaus; fourteen declare that research is conducted internally by researchers; and four countries outsource research on tax compliance to another government (research) department. Sixteen countries point out that they use the forthcoming knowledge about taxpayer compliance in practice. Note that one country that doesn't conduct or commission research does report to use this type of knowledge.

140. Thirteen countries mention one or more pieces of research that have been conducted or commissioned by the Revenue Body, of which three mention one and seven mention four or more pieces of research.

141. The researching countries were asked to indicate which 15 factors they have been researching. These factors can be clustered into six concepts:

- Deterrence—audits, perceived risk of detection and severity of sanctions;
- Possibilities—opportunities for evasion, compliance costs and complexity of tax rules and tax system;
- Norms—personal norms and social norms;
- Trust—trust in the government and or revenue body, and trust in other taxpayers;
- Economic factors—general economic factors, factors related to the business or industry and amount of tax due; and
- Fairness—fairness of treatment by the tax administration and of the tax system.

142. These concepts and their sub concepts are listed in Table 1. The third column of this table displays the number of countries that stated to have conducted or commissioned research on each of the sub concepts. The fourth and fifth column shows the number of countries that per concept have researched at least one and all of the sub concepts.

Table 1. Extent and nature of revenue body tax compliance behaviour research ⁵

Concept	Sub concept	Researching countries	> 1	all
Deterrence	Audits	10	13	5
	Risk of detection	10		
	Severity of sanctions	8		
Possibilities	Opportunity for evasion	11	14	8
	Compliance costs	11		
	Complexity of rules and system	12		
Norms	Personal norms	10	13	10
	Social norms	13		
Trust	Government or revenue body	12	12	5
	Other taxpayers	5		
Economic factors	General	6	11	2
	Business or industry	6		
	Amount of taxes	7		
Fairness	Treatment by tax administration	12	14	10
	Tax system	12		

143. Table 1 suggests that most (sub) concepts are researched by a majority of the countries. Least researched are the sub concepts of economic factors, severity of sanctions, and trust in other taxpayers.

144. Four countries indicated to have done research on other concepts than were given in the questionnaire. This research focussed on: the social construction of morals, ethics, values, norms and attitudes; general attitudes about tax compliance, general attitudes towards the revenue authority, impact of compliance communications; and the perception of the national tax level compared with that in other (European) countries; perceptions of customer experience through contact centres (largely how well did we respond to customer enquiries – utilising mystery shopper type methods – not necessarily detailed research of particular themes, issues etc..

Countries perceptions of effective indicators of tax compliance

145. The responding countries were asked to indicate to which extent the 15 sub concepts are, in their opinion, important predictors of taxpayer compliance.

⁵ > 1: Number of countries researching at least one of the sub-concepts;; ‘all’: number of countries researching all the sub-concepts.

Table 2. Mean perceived importance of concepts and sub-concepts in explaining compliance (for 18 countries)

Concept	Sub-concept	Mean	
		Sub-concept	Concept
Deterrence	Audits	2.7	3.0
	Risk of detection	3.5	
	Severity of sanctions	2.7	
Possibilities	Opportunity for evasion	3.5	3.0
	Compliance costs	2.6	
	Complexity of rules and system	2.9	
Norms	Personal norms	3.3	3.2
	Social norms	3.1	
Trust	Government or revenue body	2.8	2.5
	Other taxpayers	2.1	
Economic factors	General	2.6	2.7
	Business or industry	3.0	
	Amount of taxes	2.6	
Fairness	Treatment by tax administration	3.2	3.0
	Tax system	2.8	

146. The results in Table 2 suggest that countries generally think that norms, deterrence, fairness, and opportunities are more important concepts in explaining compliance than economic factors and trust. Risk of detection, opportunity for evasion, personal norms, treatment by the administration and social norms are perceived as the most important sub factors. Trust in other taxpayers is perceived as the least important sub factor.
147. Three countries indicated that other concepts than were given in the questionnaire are in their opinion important predictors of compliance. These concepts are: real (as opposed to perceived) opportunity, knowledge of rules, ability to follow rules (related to complexity of rules, but also takes into account level of capacity in taxpayer); historical non-compliance with the tax body or non-compliance in other similar regulatory requirements in other governmental organizations (especially multiple incidents), in case of SME owners - a history of opening and closing businesses, life stag; and actual opportunity (is the taxpayer taxed entirely at source), taxpayer abilities to keep proper records, compute tax etc, and perception as to whether tax evasion is legal/illegal.

Practical use of knowledge

148. Almost all countries state that they use knowledge on taxpayer compliance behaviour in practice. First of all, multiple countries mention the use of knowledge in general for their overall compliance strategy. Also knowledge is used for tactical plans, like choosing specific interventions or programs for different taxpayer groups (for instance, special programs for compliant, ignorant, negligent and errant taxpayers). Knowledge also has in some countries a direct impact on risk review, risk analyses, risk ranking, audit case-selection and audit prioritization (or other compliance interventions).
149. Furthermore knowledge is used by multiple countries for communication purposes. This includes mass media communication, communication to specific sectors and letters to individual businesses. Goal is either to strengthen the perception of the effectiveness of the Revenue Body (effectiveness in dealing with non-compliance) and/or to show the general compliance level to strengthen the social norms (most taxpayers are honest).

150. A few countries mention the use of knowledge for internal purposes, such as informing or educating staff. Education of taxpayers is also mentioned.
151. Finally some revenue bodies used this knowledge to implement or improve the quality of taxpayer assistance services. It is also used as input for legislative measures and a new penalty regime.
152. Even though a lot of revenue bodies make practical use of knowledge, the templates also show that in a lot of cases no practical use can be given, although an overall impact is mostly expected.

Research methods

153. Sixteen of the nineteen participating countries returned a total of 81 templates on the research they conducted or commissioned. On the template countries described this research.
154. The information on the templates was scored on eight variables. The variables were:
- Method of research: Literature / theoretical study, descriptive, correlational, or (quasi) experimental;
 - Type of data: Quantitative or qualitative;
 - Reason for study: Measuring compliant behaviour, understanding (indicators of) compliance, evaluation of treatments, or to develop new methods;
 - Dependent variable: (non) compliant behaviour, (non)compliant intentions, indicators of (non) compliance, or amount of tax paid;
 - Independent variables: Deterrence (audits, risk of detection, and severity of sanctions), Possibilities (opportunity for evasion, compliance costs, and complexity of tax rules and tax system); Norms (personal norms and social norms); Trust (trust in the government and or revenue body, and trust in other taxpayers); Economic factors (containing general economic factors, factors related to the business or industry and amount of tax due); and Fairness (fairness of treatment by the tax administration and of the tax system);
 - Target group: General public, private taxpayers, SME's, large companies, tax practitioners;
 - Practical use: None, unknown, used for....
155. Scoring the templates on these variables was often a speculative task, because not all templates were completely clear on all issues. Results should therefore be regarded as indicative and as possible input for further exploration.
156. Most of the templates present research with a descriptive (31%) or correlational (34%) method. Somewhat less templates describe a literature or theoretical study (19%), or a (quasi) experimental study (16%).
157. Descriptive research assesses variables (e.g. beliefs, intentions, behaviour, or occurrences), without relating them. The results of descriptive research give a portrait of the situation,

without shedding light on how the variables are associated (e.g. 20% of tax payers think that a majority of others evade tax; or on average it takes SME's 10 hours per week to fulfil their tax obligations).

158. Correlational research examines the statistical association between two or more (naturally) occurring variables. The results of correlational research shed light on the link between variables, but do not reveal the causal relationship between them (e.g. social norms are strongly related to compliant intentions, or SME's who report low compliance costs are found to make more errors than SME's who report high compliance costs).
159. Experimental research involves altering one or more variables in the environment and measuring the effect on (an) other variable(s). The results of experimental research give insight into the causal relationship between variables (e.g. After reading an article with strong social norms tax payers reported more compliant intentions than after reading an article with weak social norms; or audits revealed less flaws in the SME-group where the burden of administration was reduced than among SME's with their normal administrative burden).
160. The empirical research in the templates mostly made use of quantitative data (71%); a minority used qualitative (23%) and a few templates described studies that used both types of data (6%). Quantitative data could be characterized as exact information, such as numbers or amounts, and qualitative data as rich information, such as detailed descriptions.
161. Most of the research was performed to improve the understanding of (none) compliance and its indicators (65%). Other studies were conducted to measure or estimate actual (non) compliance (20%). Less frequently templates described research aimed at evaluating treatments (9%) or at developing new methods (6%).
162. The dependent measure was mostly the degree of (non)compliance (43%) or (non)compliant intentions (25%). Other templates mainly described research with the indicators of (non)compliance (22%) or the amount of tax paid (3%) as dependant variables.
163. In the templates deterrence appeared to be the most utilized predictor of compliance (67%). Fairly often cited in the templates as indicators of (non)compliance are possibilities (43%), norms (42%) and economic factors (42%). Fairness (28%) and trust (17%) are least often mentioned in the templates. Most templates present research with more than one independent variable.
164. Over half of the studies described in the templates involved SME's as target group (56%). The target group also often consisted of private taxpayers or the general public (both 23%). Large businesses (10%) and tax practitioners (3%) were less often 'targeted'. The number of cases included in the research varied between four and over a million.