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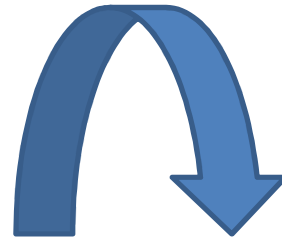
Understanding Taxpayer Behaviour

New Opportunities for Tax Administration

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INTRODUCTION

THE IRELAND CASE



- In Ireland, the Office of the Revenue Commissioners is responsible for the administration of the tax system and the customs regime. In areas of tax policy, Revenue's role is to advise the Department of Finance and others responsible for policy. The separation of tax policy and administration is found in many countries.

INTRODUCTION

- The objectives of most tax administrations, including Revenue, are to ensure compliance with tax laws and to improve taxpayers' customer service satisfaction.
- Tax administrations have a wide range of compliance and customer service programmes that aim to change behaviour among taxpayers.

INTRODUCTION

- In recent years there has been an increasing focus on better understanding the underlying factors that influence taxpayer behaviour. Research is being undertaken in Ireland, in tax administrations in other countries and at EU and OECD levels, to improve knowledge of taxpayers and their behaviour.
- This research ties in with behavioural economics, an expanding sub-discipline within economics that seeks to better explain how and why decisions are made.

INTRODUCTION

An improved understanding of taxpayer behaviour and attitudes to taxation can help tax administrations to develop stronger and more effective compliance risk treatments, as well as improve customer service programmes. This paper outlines the research and how it may be used to influence taxpayer behaviour. Many factors influence behaviour, the focus in this paper is on those that can be tested and used by a tax administration in a practical setting.

INTRODUCTION

- Traditional tools of tax administration (audit for example) are an expensive way to attempt to improve compliance even when targeted at specific tax risks. Influencing behaviour may offer an effective but less expensive option. The aim of this research is to find efficient and cost effective approaches to improving taxpayer behaviour.

FACTORS THAT INFLUENCE TAXPAYER BEHAVIOUR

- There is already a considerable literature on the subject of taxation and behavioural economics – see for example, Congdon *et al.* (2011, 2009) for useful summaries.
- However, for the most part, this literature is focused on the implications of behavioural or psychology research for tax policy or tax design.

FACTORS THAT INFLUENCE TAXPAYER BEHAVIOUR

- As noted in the Introduction, in Ireland and many other countries there is separation between tax policy and tax administration. Using behavioural research to inform tax administration is a less developed but growing area in the literature.



- The work of a tax administration includes activities that cover both compliance and customer service.

FACTORS THAT INFLUENCE TAXPAYER BEHAVIOUR

- In addition, large elements of the tax system in Ireland are based on self-assessment. In this context, there is clearly potential to influence behaviour to improve compliance.
- The central contribution of behavioural research to tax administration is to understand why taxpayers are compliant or not. This can inform the work of tax administrations across a range of their functions.

FACTORS THAT INFLUENCE TAXPAYER BEHAVIOUR

- Several factors that contribute to the level of compliance in a taxpayer population have been identified. The sections below present an overview of these factors and Section III examines the relevant findings for Ireland.
- The factors are grouped under headings adapted from research by the OECD Forum on Tax Administration (OECD, 2010): deterrence; norms (personal and social); fairness and trust; complexity; and the role of government and broader economic and social factors.

Deterrence Effects

- The standard model of tax compliance, derived from Becker (1968) and Allingham and Sandmo (1972), assumes that a rational taxpayer assesses the costs and benefits of evading taxes. If the expected benefits (less income “lost” to tax) outweigh the costs (the chances of a non-compliant taxpayer being caught and the sanctions incurred) then the taxpayer will evade tax. The taxpayer makes a rational choice having considered the options.

Deterrence Effects

- Deterrence is a vital tool (audit, other interventions and sanctions) for any tax administration. A targeted approach to deterrence is likely to be more effective.
- Increasing the perceived likelihood of getting caught raises the cost of evasion. The tax administration has other options to reduce opportunities for evasion as well as increasing the likelihood of audit or imposing harsher sanctions.

Deterrence Effects

Deterrence (the risk of detection and the punishments incurred) should positively influence taxpayer compliance (Slemrod, 2007). However, the empirical evidence is somewhat mixed. OECD (2010) discusses several studies that examine the role of deterrence. Some findings are as expected (increases in the probability of detection improve compliance) but the effects are quite weak. One reason is that auditing compliant taxpayers is found to sometimes undermine their willingness to comply.

Deterrence Effects

- The standard model alone is not enough to explain the level of compliance in society (Braithwaite, 2009; Phillips, 2011).



The evidence suggests that, given the probability of being caught evading taxes and the size of the punishment if caught, the level of tax evasion should be higher than it is in many countries (i.e., that taxpayers should evade taxes more than they actually do). One explanation is the tendency of people to overestimate the probability of being audited and the sanctions that might follow if evasion is uncovered (Reeson and Dunstall, 2009).

The Impact of Norms on Behaviour

- A key factor in tax compliance is a widespread desire to “do the right thing”.
- Taxpayers seek to comply because they believe it is the right thing to do, not because of fear of punishment if they do not comply (Wenzel, 2005). The desire of a taxpayer to comply is strongly linked to behavioural norms, both the personal norms (and/or beliefs) of the individual taxpayer and the social norms that prevail in society at large.

The Impact of Norms on Behaviour

- Personal norms are the result of a combination of factors inherent to the individual. These guide a taxpayer's posture to the tax administration but are difficult to influence (OECD, 2010; Kirchler, 2007). Tax administrations can try to send messages that stress the importance of compliance to educate taxpayers and build up positive personal norms.
- Engagement by tax administrations with young people (early working age or younger) can influence their personal norms and this benefits tax compliance in the long term.

The Impact of Norms on Behaviour

- There is evidence from diverse areas (not just tax related) that people seek to conform to social norms and that the behaviour of others strongly influences an individual's choices (OECD, 2010). This influence is important though in many cases people do not consciously realise it. This effect can be heightened when the relationship to the social grouping is stronger or closer. Peers or neighbours may exert greater influence than those more distant to the individual (BIT, 2012).

The Impact of Norms on Behaviour

- Social norms influence taxpayer behaviour. If there is a perception that tax evasion is limited and the majority of the people are compliant, this makes people less willing to evade taxes themselves. If people believe that non-compliance is more prevalent than it is in practice, correcting misperceptions regarding the scale of evasion is also a positive way to reinforce compliance. Wenzel (2001a, 2001b) demonstrates this in the Australian case.

Fairness and Trust in Tax Administration

- Whether an outcome is perceived to be fair will influence behaviour.
- Experiments have shown that people prefer an option in which they receive no reward to an option in which they are rewarded but is perceived as unfair – they are rejecting an outcome that would make them better off (Braithwaite, 2009; Delaney and Harmon, 2009).

Fairness and Trust in Tax Administration

- Often trust and legitimacy are linked to fairness, as the perceived fairness of an outcome will be contingent upon them. OECD (2010) discusses three types of fairness in taxation: distributive fairness (the perception that government acts as a wise spender of tax revenues); procedural fairness (the perception that the tax administration adheres to procedures that are fair in dealing with taxpayers); and retributive fairness (the perception that the tax administration is fair in applying punishments when the rules are broken).

Fairness and Trust in Tax Administration

- The latter two are more relevant to (and can be influenced by) tax administrations. Distributive fairness depends on policymakers.

Fairness and Trust in Tax Administration

- If taxpayers do not trust the tax administration to collect tax fairly, this will increase non-compliance (Murphy, 2004).
- A perception of fairness and trust are important tools for a tax administration in attempting to reduce evasion. The key to establishing trust is to frame the collection of taxes to the population in a transparent manner and emphasise the fairness of the approach taken.

Fairness and Trust in Tax Administration

Norms and the motivation to pay taxes are influenced by fairness – both in how a person is treated by the administration individually and perceptions of fairness of the taxation system in general (whether other people are also paying their fair share). If a tax administration can demonstrate its commitment in these areas, compliance should benefit.

Fairness and Trust in Tax Administration

A “service and client” approach by the tax administration is more likely to encourage trust than a “cops and robbers” approach based on sanctions (Kirchler, 2007; Torgler, 2011). The more respectfully taxpayers are treated by the tax administration, the less likely they are to evade and this contributes to the desire to “do the right thing” (NEF, 2005). Revenue’s customer charter and the presumption that taxpayers are honest reflect this type of approach.

Complexity of the Tax System

A key assumption in decision making is that people are capable of assessing a range of complex choices, and by correctly evaluating all of the available information, select the option with the best outcome for them. In reality it is rare to find situations in which people are fully informed of all their choices and always select the best option (Thaler and Sunstein, 2008).

Complexity of the Tax System

Faced with a range of choices, picking the correct option depends on calculating probabilities of events or risks occurring. In practice people tend to revert to rules of thumb (heuristics). While these rules of thumb may work in many cases, which explains why people fall back on them, they will be subject to biases by the person and this can lead to poor choices (Delaney and Harmon, 2009).

Complexity of the Tax System

For many people, tax is a complex subject and this complexity has been shown to contribute to non-compliance (GAO, 2011). OECD (2010) argues that tax administrations have tended to overlook the “lazy non-compliers” – taxpayers who would have complied if the opportunity for compliance had been easier.



A range of concepts that influence decision making have emerged from behavioural research and several that closely relate to taxation.

Complexity of the Tax System

If the administration reduces complexity, this should lead to improvements in taxpayer behaviour.

Ways to make it easier to comply include the use of plain language in communications and simplifying forms and tax laws where possible. Assistance directed at lowering unintentional non-compliance (genuine taxpayer error) should reduce evasion and perhaps boost the legitimacy and perceived fairness of the tax administration.

Complexity of the Tax System

Significant shares of taxpayers in Ireland and many other countries use the services of tax agents and advisors.



The use of advisors often reflects the complexity of the tax system and simplification may reduce this burden on taxpayers. However, agents also offer a channel to lower uncertainty via engagement with the tax administration. Interactions between Revenue and tax agents and representative bodies can improve communication and influence compliance. Cooperation can help to achieve buy-in and support for changes in the tax system.

Broader Economic and Social Factors

- There are many more factors that influence the level of compliance in a population beyond those outlined above. These are grouped together here, as they are mostly beyond the control of the tax administration. Some involve tax policy or public spending, while others relate to the broader economy. As noted in the Introduction, the focus of this paper is on methods that provide practical tools for tax administration to influence behaviour.

Broader Economic and Social Factors

Economic conditions are important to compliance. For example, businesses with liquidity problems may be more likely to consider evading taxes. Although the research is limited, at a more macroeconomic level, factors that promote growth also encourage tax compliance (OECD, 2010).

Broader Economic and Social Factors

Likewise, economic downturns are often associated with increased evasion. Higher tax rates are linked with evasion if they incentivise taxpayers to move into the shadow economy.

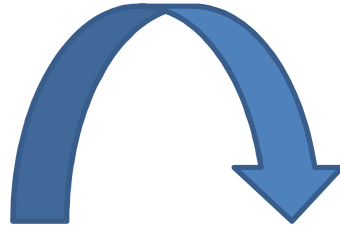
Interactions Between Factors



This section examines in more detail the influence of these five factors for Irish taxpayers but it should be clear that no single factor can explain the compliance attitude or behaviour of an individual.

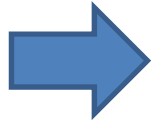
It is the interaction of the factors and their varying importance that contribute to compliance behaviour at the individual and population levels.

Interactions Between Factors



There are complementarities between the factors but there are also some potential conflicts that should be considered from the tax administration perspective. As noted above, there is likely to be a compliance gain from addressing misperceptions, for example if the level of tax evasion in society is perceived to be higher than it is in reality.

Interactions Between Factors



However, some misperceptions may benefit compliance. For example, the perceived probability of being audited (or other deterrence measures) may be higher than the actual level. While openly correcting this misperception may build trust and improve the perceived fairness of the administration, it could be at the expense of weakening the deterrence factor due to the lower audit probability.

Principles of Influence

To move from the literature to practical applications of the behavioural insights, Cialdini's principles of influence offer a useful structure. Cialdini (2001) develops six principles that can be applied to influencing individuals' behaviour and decision making. OECD (2009) further develops a series of possible applications to tax administration.

Principles of Influence

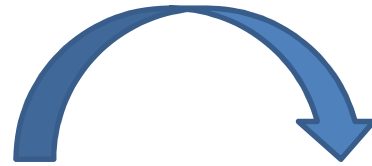
<i>Influence Principle</i>	<i>Explanation</i>	<i>Potential Tax Application</i>	<i>Link to Behavioural Factors</i>
<i>Reciprocity</i>	People feel obligated to return favours	Indicate to taxpayers the ways in which the tax administration can assist them and emphasise the benefits of compliance	Fairness and Trust Complexity
<i>Authority</i>	People look to experts to show the way	Take opportunities to communicate the tax administration's relevant expertise and experience in taxation matters	Complexity Deterrence
<i>Commitment and Consistency</i>	People want to act consistently with their values	Allow taxpayers the possibility to communicate their commitment to compliance and to show consistency with previous actions	Norms (personal) Fairness and Trust
<i>Scarcity</i>	People place higher values on resources that are limited	Attempt to characterise compliant behaviour as avoiding losses and show that the tax administration is unique as its services to taxpayers cannot be offered by anyone else	Deterrence Complexity
<i>Social Proof and Consensus</i>	People look to others to guide their behaviour	Signal to taxpayers that compliant behaviour is the norm but be wary of publicising evasion as severe or widespread as this may legitimise undesirable behaviour	Norms (social)
<i>Liking</i>	People are supportive to ideas or actions they like	Emphasise the positive aspects of the tax administration's work and the tax system to improve taxpayers' views	Norms (personal) Fairness and Trust

Source: Based on Cialdini (2001) and OECD (2009).

TAXPAYER ATTITUDES AND BEHAVIOUR IN IRELAND

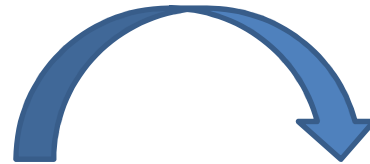
- This Section identifies the factors that impact on taxpayer behaviour from the research literature.
- OECD (2010) provides some information from surveys of tax administrations on their perceptions of the influence of these factors on compliance.
- However, it is important to know which of these factors are the most relevant in determining the behaviour of Irish taxpayers.

TAXPAYER ATTITUDES AND BEHAVIOUR IN IRELAND



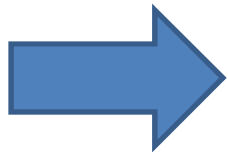
Revenue has considerable sources of information on taxpayer behaviour and attitudes in Ireland. Of most relevance to discerning the determinants of behaviour are a series of taxpayer surveys. Revenue has conducted four surveys involving small or medium sized enterprises (SME 2006, 2008) or pay as your earn (PAYE 2007, 2009/10).

TAXPAYER ATTITUDES AND BEHAVIOUR IN IRELAND



In addition to these four surveys, Revenue also commissioned an independent survey of attitudes and behaviour towards taxation from a third party market research company in 2008/09.

TAXPAYER ATTITUDES AND BEHAVIOUR IN IRELAND



The results are not discussed here as the survey has not yet been published but they show similar outcomes across the ranges of issues examined below and provide external validation for the results of the Revenue conducted surveys.

SME Attitudes to Compliance

- Overall satisfaction with the service taxpayers receive from Revenue is high. Among SMEs, 87 per cent of those that responded to the 2008 survey are either satisfied or very satisfied (up from 84 per cent from the SME 2006 survey). For PAYE taxpayers, the satisfaction level is 91 per cent in the 2009/10 survey (up from 88 per cent in 2007).


SME Attitudes to Compliance

- The survey of SMEs in 2008 asked respondents to rate the influence that ten statements have on their compliance. SME taxpayers' compliance appears to be highly influenced by factors related to personal norms. Factors such as *Doing the 'right thing'*; *Because it is the law* and *Presumption from Revenue that you have been honest* are indicated as having a strong influence on compliance.

SME Attitudes to Compliance

The *Belief that other taxpayers are declaring and paying honestly* is less influential. *Concern at having to pay interest charges for late payment of tax* is indicated as the most influential within the topics related to deterrence. Other deterrence factors such as *Concern that Revenue will obtain a court judgment against you for failure to pay tax and publish details of that judgment;* *Concern that you will be published on the Quarterly Defaulters List* and *Concern that you will be audited by Revenue* are influential for a sizeable share of the respondents. *Concern that a 3rd party owing you will pay Revenue* is influential only for small share of cases.

SME Attitudes to Compliance



The SME 2006 survey asked respondents about their perceptions of *Revenue's fairness in administering taxes and duties*; *Revenue's efficiency in administering taxes and duties*; *Revenue's effectiveness in dealing with evasion* and *whether public confidence in Revenue is justified*. Across all four statements over two-thirds of respondents agree or strongly agree that Revenue is fair, efficient, effective and has the public's confidence. Less than 10 per cent disagree or strongly disagree in any of these areas.

PAYE Taxpayers' Attitudes to Taxation

- The PAYE 2007 survey asked respondents for their views of Revenue's customer service delivery. Over 70 per cent agree or strongly agree with statements that *Revenue explains my tax credits and relief entitlements* and *Revenue makes it easy for me to claim* [credits and entitlements]. On questions related to Revenue's response speed and the courteousness and helpfulness of Revenue staff, agree or strongly agree responses are 90 per cent or higher.

PAYE Taxpayers' Attitudes to Taxation

- The PAYE 2009/10 survey included a series of questions on taxpayers' attitudes to tax compliance (and compliance with other regulations) to which the respondents were asked to “agree” or “disagree”.

PAYE Taxpayers' Attitudes to Taxation

- Significant majorities agree that *It is not acceptable to declare some but not all income for tax purposes (85 per cent); It is not acceptable to buy services knowing the income from them will not be declared to Revenue (83 per cent); It is not acceptable to claim credits or reliefs from Revenue that you are not entitled to (92 per cent).*
- *Those who evade tax repeatedly should receive a jail sentence (86 per cent) and It is acceptable to report tax evaders (92 per cent).*

PAYE Taxpayers' Attitudes to Taxation

The above statements reflect some of the personal norms around tax evasion. It is interesting to note that a lower share (73 per cent) consider it unacceptable to legally avoid paying taxes by using loopholes in legislation. Also, only 72 per cent consider it unacceptable to purchase goods abroad, over the customs limit, and not declare them to customs on returning to Ireland.

PAYE Taxpayers' Attitudes to Taxation

The responses related to statements that reflect social norms are slightly weaker. Only 69 per cent believe deliberate tax evasion is considered unacceptable by Irish society. While 77 per cent believe Revenue has been successful in dealing with tax evasion in the last five years and 76 per cent believe Revenue is able to detect people not paying the right amount of tax, 81 per cent agree that deliberate evasion is on the increase.

Summary of Survey Findings

- The results across the taxpayer surveys indicate that deterrence remains an important determinant of compliance behaviour, as do fairness and trust. The majority of the population considers tax evasion unacceptable and views on Revenue's effectiveness in dealing with evasion are positive.

Summary of Survey Findings

- There are suggestions in the responses that tax avoidance and customs issues are seen less unacceptable than tax evasion by some respondents. Responses related to personal norms are strong from a compliance perspective but the responses to statements that reflect social norms appear weaker. Many respondents hold positive personal beliefs with regard to tax compliance but the level that believe the same beliefs are widespread in society is lower.

Summary of Survey Findings

- This demonstrates the importance of misperceptions that may negatively influence compliance behaviour. The actual level of non-compliance in Ireland is most likely well below the perceived level reported in the social norm related survey questions. The independent survey of attitudes and behaviour referred to in the introduction to Section III shows that only 3 per cent of people in Ireland actually engage in undeclared work (in a separate Eurobarometer (2007) study 4 per cent of Irish respondents admitted to engaging in undeclared work).

INFLUENCING TAXPAYER BEHAVIOUR

- Behavioural research is providing a deeper understanding of taxpayer behaviour. In the context of tax administration, the behavioural literature offers a framework for influencing taxpayers to improve compliance and customer service.

INFLUENCING TAXPAYER BEHAVIOUR

- The five factors determining tax compliance provide a basis (interactions between the factors should not be ignored). Cialdini's principles of influence are a useful model as to how to apply the factors at a practical level.
- While there is no best practice guide, this framework offers a structure to guide tax administrations seeking to change behaviour.

INFLUENCING TAXPAYER BEHAVIOUR

- The framework is informed by domestic and international research, from academic and tax administration sources.
- Results suggest that deterrence, the traditional tool of tax administration, is important but not sufficient to explain the level of tax compliance in society.

INFLUENCING TAXPAYER BEHAVIOUR

- Other factors are important, particularly the influence of personal norms and the trust in the tax administration. The perception of prevailing social norms is also important but appears to exert less influence on taxpayers than personal norms.

INFLUENCING TAXPAYER BEHAVIOUR

Tax administrations have many treatment tools available to change behaviour. However, tools like audit are expensive. Understanding and influencing behaviour offers an effective approach to complement other options. This is particularly the case for treatments that seek to improve voluntary compliance. Relatively small scale but targeted interventions can have large effects on behaviour.

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