

Use power such as audit and enforcement actions in a way that strengthens trust

Research shows that actions by a Tax Administration whether audits, enforcement or recovery actions may have a positive or negative impact on taxpayers' motivation to comply with their obligations. The effects may be short-term or long-term, and in some cases, the short-term effects may be different from the long-term ones. For example, an enforcement action may be immediately effective but if it is seen as illegitimate or unfair, it may reduce the motivation to comply in the future. Powerful tools such as enforcement, used in the correct way by a Tax Administration, can influence norms and strengthen trust. As a result, if enforcement is viewed to be legitimate, supportive and fair it will influence the right behaviours and trust in the system will grow. Consequently, enforcement should always be viewed as a tool to protect compliant taxpayers.

Enforcement should be framed as a service to compliant behaviour

Power and enforcement actions should be used primarily as an action to improve compliant behaviour. The perception that the vast majority of taxpayers are compliant increases voluntary compliance. For this reason, it is important to assist taxpayers that want to comply but are unable to do so and to show compliant taxpayers that fraudsters and cheats will not get away with tax evasion or tax avoidance. In this regard, enforcement is protecting the compliant majority from being exploited by those who do not pay their correct taxes with the added benefit of helping to maintain fair competition and ensuring a level playing field for all.

Detecting and sanctioning non-compliance is the primary goal of auditing programmes. These programmes should also aim to raise awareness that risk based audits are targeted at non-compliant behaviour. The main message should be one that underlines the social norm (most people comply) and highlights that enforcement is there to target tax evaders and tax avoiders. Proactive and clear communication with taxpayers will strengthen trust and increase voluntary tax compliance. Enforcement actions should be well targeted, correctly explained and operated in a correct manner, showing respect and aiming to treat the taxpayer in a fair way.

In the area of Compliance Risk Management (CRM), in depth work has been carried out by the Fiscalis Risk Analysis project group. The aim of the CRM's work is for Tax Administrations to have strategies in place that will help them improve voluntary compliance levels and to ensure that non-compliance with tax laws is kept to a minimum. In this regard, trust is an essential cornerstone of voluntary compliance, with CRM as an important tool to achieve this goal.

Make sure to target fraudulent behaviour

The use of power in the sense of forced compliance, as a contrast to voluntary compliance, should be reserved primarily for addressing instances of deliberate non-compliant behaviour. This has a direct effect on those targeted and an indirect effect in that compliant taxpayers can see that non-compliant behaviour is being tackled and corrected. Resources and sanctions should be focused on high risk cases, as actions against compliant taxpayers could have a negative effect. This could be complemented by random audits, specifically to gather information on the type of errors made and to estimate the tax gap. Generally speaking, enforcement should always be proactive and transparent, i.e. aiming to change existing behaviours. This ensures that the use of power is perceived as legitimate.

Ensure everyone gets a chance to comply

A culture that assumes that all taxpayers are trying their best to do the right thing should be recognised by the Tax Administrations employees. If an error is identified by the Tax Administration, the proactive solution would be to offer guidance and assistance on how to correct the mistake before any enforcement actions are undertaken. Documents written in plain and understandable language, online services that are designed with the customer in mind, comprehensible tax laws and procedures will assist taxpayers to comply with their tax obligations.

Consider enabling the option of giving second chances

Bearing in mind that taxpayers want to do the right thing, Tax Administrations should consider providing opportunities for taxpayers to correct any unintentional errors made without penalties. This approach will encourage engagement between the Tax Administration and the taxpayer on any possible tax defaults. This approach could be useful when new legislation or criteria are introduced and taxpayers make unintentional mistakes because they are unfamiliar with the new rules.

Country Examples

BELGIUM:

Belgium's Federal Public Service Finances experimented with different messages targeting late payers. This was done as part of a series of behavioural experiments to test new compliance approaches. Randomised-Controlled Tests add to an evidence-based policymaking with an eye for effect measurement of what a Tax Administration does.

One of the reminder letters (Personal Income Tax) framed enforcement actions on late payment as an instrument to protect and serve the majority of compliant taxpayers. The letter contains a paragraph that states: *'We aim at an early collection of debts and go after non-voluntarily paid taxes **out of respect for all taxpayers that do pay their taxes timely and correctly.***

Taxpayers appreciate this new approach. Redesigned and rewritten letters, that are simplified and personalised help taxpayers to be compliant and make them pay sooner compared than the original letters. Clear messages and relevant calls to action make it easier to pay and contributes to improved tax compliance levels. Behavioural insights continue to inspire the Belgian compliance strategy. A dedicated unit on Tax Compliance and Behavioural Insights was set up to study taxpayer behaviour and build connection and trust.

GREECE:

Press releases throughout the year as well as published annual reports detailing the audit results allow the taxpayers to have a transparent view of the Greek Tax Administrations actions. Also, all taxpayers are given the chance to submit an amending Income Return in a limited time period.

Transparency is one, if not the most, important virtues of democracy. People need to know that they are equal towards the law, including the tax law. Publishing the results of audits (just

the results not the taxpayer's personal data) show people that honesty matters and that breaking the law and tax evading is a criminal act and is handled as such. Though it is a repressive measure in nature, yet it can and does work as a preventive measure as well, since taxpayers realize that tax evaders do not skip punishment. Thereby, compliant taxpayers do not feel that obeying the law is useless and underestimated.

As for the opportunity provided to amend an Income Return, this makes taxpayers feel that they are somehow forgiven for hiding facts from the Authorities and are respectfully requested to prove themselves honest. This is also linked to the Independent Authority for Public Revenue (IAPR) being lenient towards people, yet strict towards problems. No one is treated as deliberately dishonest from the outset but as accidentally misled.

SPAIN:

Virtual Visits for Auditing (VIVIs)

One of the most recent IT tools launched by the Spanish Tax Agency is the “VIVI” project (Virtual Visits for Auditing). It started in 2019 as a pilot jointly developed by the Tax Auditing and the IT Directorates for the implementation of some auditing procedures and, in June 2020, the General Tax Act was modified to allow the use of this tool and extend it to the rest of the tax application procedures.

Many taxpayers need to meet in person with the tax officials to work in an atmosphere of trust, which may not always be achieved with online or phone contacts. This is even more important in the course of enforcement procedures, where tax administrations should try to strengthen the available services. The AEAT sought a more efficient way to develop traditional face-to-face visits for the cases that it is not strictly necessary the onsite meeting. “VIVIs” have been developed to be fully compliant with the tax auditing procedure established in the Spanish Law, thus granting the virtual visit the same validity as a live meeting. As additional advantages, it enables a full digitalisation of the file and is sustainable and ecologically responsible since the use of paper is limited and the carbon footprint is reduced by saving on travel.

Even though the actions are carried out telematically, the system has incorporated a series of tools that guarantee the protection of data, the authenticity and integrity of documents and the identification of taxpayers and tax officials always.

For this solution to reach its full potential, the system will include the possibility to sign documents and exchange records or other documents, just as it would happen in a face-to-face meeting but by electronic means. Of course, the taxpayer must consent to the use of the system.

Consequently, VIVI includes or is connected to the following tools:

- A videoconferencing system
- An Electronic Registry to load documentation delivered by the taxpayer
- The electronic signature of both the tax official and the taxpayer
- The electronic file of the taxpayer, so that the tax official can access to all the information

The tax official and the taxpayer agree on the appointment for the visit. The tax official acts as moderator of the videoconference and decides what is shown on the screen. However, if the taxpayer wants to comment on some data of the documents he has presented, the tax official will allow him use of the keyboard and mouse.

The project started before the breakout of the COVID-19 crisis, but the latter has boosted the use of such tools to ensure the continuity of the business and the safety of taxpayers and tax officials. Therefore, the Spanish Tax Administration has taken this opportunity to speed up its implementation.

SWEDEN:

Communication of planned audits to strengthen norms

One of the main objectives for enforcement in the Swedish Tax Agency (STA) is to strengthen social norms. One way to achieve this is to actively communicate and be transparent about planned audit and control activities. By communicating these in advance, a signal is sent to taxpayers in general that STA are handling tax evasion and non-compliance 'on their behalf'. It means that they can focus on running their businesses in a context of fair competition. Consequently, it also creates awareness about the planned actions. The objective of this communication is therefore to strengthen their social norm of voluntary compliance and willingness to comply.

The main activity in communicating planned audits and control is an annual Press conference. The conference, which is hosted by the Director-General, consists of presentations by STA experts from different areas. Not all control activities within STA are communicated at the conference, some are taken up in more targeted media initiatives or not at all. The focus is on those activities that have a high priority and are deemed relevant to society, i.e. that has the most potential to strengthen norms. Information about planned audits are often combined with other relevant information such as introduction of new legislation, economic impact on businesses and guidance on how to manage complex taxation issues. Guidance not only assists compliance in the technical sense, but also reinforces the signal that the Tax Administration expects people to want to do the right thing as long as we provide assistance, thereby strengthening social norms.

These are some of the subjects that has been included in the press conference in recent years:

- **Tax evasion** in specific areas (e.g. VAT fraud, systematic undeclared work), often combined with their impact on society as a whole including labour crimes and money laundering, even human trafficking.
- **International taxation issues**, for example the use of information exchange, transfer pricing and the handling of "leaks" such as Panama Papers
- Targeted initiatives in **sectors with a high-level of non-compliance** (e.g. cleaning, transport, construction). The main target group is compliant taxpayers in those sectors with the message that they should achieve fair competition.
- **Society issues** (e.g. organised crime, use of false identities for tax or other crimes) – where taxation is just one component of a larger societal problems, often in collaboration with other government agencies such as the Police and the Social Securities Agency

- Areas where **SMEs make errors** in their normal running of their businesses, such as benefits, private costs, company cars etc. As most of these errors are common and could be due to complex rules, facts about controls is often combined with information and reference on how to do comply with the rules in the easiest way.

The press conference is followed by in-depth interviews with the STA experts on national media (radio, TV, web etc.). Furthermore, reporters often make follow-up articles later on about audit results. Sometimes it influences the media agenda and introduces new subjects into the public debate.

Internal evaluation at the STA has shown that the annual press conference generates a high level of awareness about planned controls. A dedicated media analysis is made after the event which is cross-referenced against the STA's general surveys on taxpayer confidence (which obviously is influenced by many factors).

Research

Enforcement must be done right to have overall positive effects on compliance

There is no doubt that enforcement tools such as audits remain an essential part of a tax administration's toolkit. There is plenty of evidence that enforcement can increase compliance through deterrence. However, a large and growing body of research examining both economic and psychological factors shows that enforcement must be used with great care to yield net benefits:

- While deterrent effects are well established, more and more studies document that they are neither universal across types of taxpayers (e.g., **Laine, Silander & Sakamoto 2020**) nor different socio-economic and cultural contexts (e.g., **Williams & Horodnic 2017**).
- Moreover, even when desired deterrent effects of audits materialize, audits may at the same time be perceived as coercive rather than legitimate and thus negatively affect trust, tax morale and, hence, voluntary compliance (e.g., **Kaplanoglou & Rapanos 2015**).
- The way audits are handled by the tax authority also matters: while research shows that delayed feedback on audits can have significant deterrent effects on future compliance, it comes with a price because the audited taxpayers perceive the process and the tax authority as more unfair (**Muehlbacher et al. 2012; Kogler, Mittone & Kirchler 2016**).
- In addition, even less intrusive measures such as supervision on timely tax payments may lead to delayed tax payments, indicating a crowding-out of intrinsic motivation to comply (**Gangl, Torgler, Kirchler & Hofmann 2014**).

Power, if perceived as coercive, may reduce trust and voluntary compliance

In a recent study for the Taxpayer Advocate Service in the USA, **Erard et al. (2019)** conducts a survey on how audited and non-audited taxpayers perceive the tax system and the Internal Revenue Service (IRS). They find that audits tend to induce negative attitudes among audited taxpayers, who tend to perceive greater coercive power within the IRS, have relatively less trust in the agency, and express weaker sentiments with regard to voluntary compliance. Furthermore, audited taxpayers are also relatively more likely to indicate that paying taxes feels like something is taken away from them, rather than as a contribution to society. Regarding the effects of audit on compliance, the conclusion is mixed: Audited taxpayers do report a higher perceived level of audit risk, but they also perceive a relatively low level of sanctions for noncompliance.

Gangl et al. (2015) further explores the double-edged nature of coercive power using survey data from a representative sample of Austrian self-employed taxpayers. They find that trust is closely linked to perceptions of legitimacy: taxpayers who consider coercive power to be illegitimate tend not to trust the authority, whereas those who consider coercive power to be legitimate tend to trust the authority. This, in turn, may determine whether citizens' interactions with the authority is characterized by antagonism and lack of compliance or synergism and compliance. Which of these perceptions of power dominate may depend on perceptions of how coercive power is used: targeted against non-compliant taxpayers to safeguard the cooperative majority (i.e., *retributive justice*) or randomly to threaten all taxpayers in general to comply.

Retributive justice is important for voluntary compliance

Based on survey data from a sample of self-employed taxpayers, **Kogler, Muehlbacher & Kirchler (2015)** finds that while perceived retributive justice has no direct effect on the taxpayer's own compliance, it does have a significant positive effect on trust, which in turn leads to voluntary compliance. At the same time, perceived retributive justice is positively related to the perception of power as being legitimate, which is important in building or maintaining a service- or confidence-based tax climate.

Sjoberg et al. (2019) conduct a survey experiment based on a very large sample of 65,000 respondents from 50 countries, which allow the authors to assess causal effects across a wide range of contexts. The study shows that increasing the salience of anti-corruption efforts has a significant effect on tax morale, and that this effect is quite homogenous across countries. Thus, the study provides evidence that retributive justice is an important driver of tax morale and, hence, voluntary compliance.

Different tax climates, different enforcement strategies

In an experimental study of behavioural responses to authority, **Silverman, Slemrod & Uler (2014)** investigates the interplay between two sources of authority - authority "to" (legitimate power) and authority "in" (expert knowledge) – as drivers of compliance. They find that neither affects voluntary compliance without the other, while together they induce more voluntary compliance than any other combination of policies. This indicates that the reaction to an authority depends on whether that authority is perceived to be legitimate.

Using survey data from taxpayers from three culturally different countries (Austria, Finland, and Hungary), **Gangl et al. (2020b)** find that coercive power is negatively related to implicit

trust and in turn to intended tax compliance. This shows that coercive power's positive impact on tax compliance is undermined if coercive power reduces implicit trust. The study also shows that for all countries, legitimate power positively affects tax compliance intentions only via reason-based trust, thus supporting previous findings about the relationship between legitimacy and trust.

Based on a combination of an online and a lab experiment, **Gangl et al. (2020a)** argues that depending on the perceived interaction history between tax authority and taxpayer, different policies are needed to build or maintain confidence. They find that in an antagonistic climate, a combination of high coercive and high legitimate power can change the climate to one of confidence. Importantly, however, the same power combination applied in a confidence climate actually erodes this climate. Thus, the strategies and instruments needed to move from an antagonistic or service climate to one of confidence may no longer work - or can even be counter-productive - once a confidence climate has been established and needs to be maintained.

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