

REVIEW OF RECENT LITERATURE

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This section provides a brief review of selected peer-reviewed publications from the first half of 2016 that investigate aspects of taxpayer and tax authority relations. It does not purport to be comprehensive, but rather gives a flavour of the variety of research studies from around the world. They are presented under broad headings, and in no particular order within those headings. The papers summarised here come from a variety of disciplinary backgrounds including economics, psychology, law and public policy.

TAX AUTHORITIES

Blank, J. D. & Osofsky, L. (2016) “Simplexity.”

To state it in simple words, simplexity occurs when a simple form hides a complex content. To comply with The Plain Writing Act of 2010, the IRS has to explain the tax law to individual taxpayers in plain language. Simplification can reduce the cost of compliance for taxpayers and the cost of administration for the tax authority, therefore potentially increasing tax revenue. However, according to the authors, the attempts by the IRS to use plain language in explanations of the complex tax law do not always benefit taxpayers. In particular, a plain language explanation of a law may fail to explain it in full. One negative consequence of this might be unequal outcomes for taxpayers, when sophisticated taxpayers will bear the lowest cost of simplexity. The authors offer a number of approaches that aim to address the drawbacks of simplexity while, at the same time, preserving its benefits. “Red-flagging”, for example, would require the tax authority to highlight the simplifications explicitly and to describe briefly alternative reasonable interpretations of the law.

Blank, J. D. (2017 – Forthcoming) “The timing of tax transparency.”

The focus of the paper is on the interesting and often overlooked aspect of fairness in tax law administration, namely, the timing of the public disclosure measures. The author argues that the accountability of a tax authority, such as the IRS, can be improved without undermining its ability to enforce the tax law, by requiring public accessibility for the documents related to taxpayers' tax affairs reflecting *ex ante* tax administration (for example, advance tax rulings or agreements), while preserving privacy for the documents reflecting *ex post* tax actions (audits or settlements).

Boll, K. (2015) “Proactive public disclosure: A new regulatory strategy for creating tax compliance?”

The paper describes a regulation strategy, termed “proactive public disclosure”, recently implemented by Danish Customs and Tax Administration (SKAT) against business engaged in VAT fraud. The strategy seeks to engage consumers in the enforcement of VAT compliance;

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namely, specific consumers who were buying products or services from non-VAT registered businesses were actively informed about that - although, in principle, any consumer could access the VAT registration information for any business in the public domain on the SKAT website. Thus, the strategy targets a third party rather than tax law offenders. The analysis in the paper shows that, in the context of the principles of Danish public administration, the strategy of proactive public disclosure does not violate the Duty of Confidentiality, but is incompatible with the Good Public Governance. The reason for the latter is that the information is used to expose tax offenders and to threaten them in order to induce compliance, and such a behaviour would not be compatible with good practices for private debt collectors.

Lederman, L. (2016) “The IRS, politics, and income inequality.”

In this note, Lederman describes what she believes to be the problems of inadequate funding of the IRS by the U.S. Congress and, overall, lack of strong congressional support of the IRS, which have led to the deterioration of enforcement statistics and a reduction of the IRS service to taxpayers. Lederman argues that a decline in enforcement and taxpayer service ultimately benefits those high-income and wealthy taxpayers who are more likely to engage in tax avoidance and tax evasion activities more, thus leading to growing inequality in the United States. She suggests that politicians favouring progressive income tax should appeal to fight against inequality in attempts to achieve a “more balanced treatment” of the IRS by the Congress.

TAX COMPLIANCE

Bornman, M. and Stack, E. M. (Lilla) (2015) “Specific rewards for tax compliance: Responses of small business owners in Ekurhuleni, South Africa.”

The purpose of this study was to investigate the effect of rewards on tax compliance behaviour. While a reward may encourage the desired behaviour, it can also crowd out an intrinsic motivation. To explore this issue, and to establish whether a specific form of a reward plays a role, the authors conducted a survey among small businesses in a metropolitan area of Ekurhuleni in South Africa. The survey participants were offered two scenarios of rewards by the tax authority for timely submission of tax returns: a lottery ticket, with a chance of winning a substantial prize, and a certificate with public acknowledgement of being a tax compliant business. The participants were asked a number of questions about the extent of their support of the reward. The results suggest that businesses support the recognition of their compliance by the tax authority, with little difference between the two scenarios. Younger entrepreneurs and smaller businesses appeared to be more in favour of the rewards; there was little difference in responses by education, race, and gender of the respondents, and by the type of industry.

Bruhn, M. & Loepnick, J. (2016) “Small Business Tax Policy and Informality: Evidence from Georgia.”

This paper explores the introduction, in 2010, of a preferential regime for small businesses in Georgia, and the way in which it affected both firm creation and tax compliance. The authors measure bunching below the eligibility threshold and find evidence of underreporting. The analysis is based on administrative data provided by the Georgia Revenue Service and provides insights into taxation and informality.

Casal, S. & Mittone, L. (2016) “Social esteem versus social stigma: The role of anonymity in an income reporting game.”

In this paper, participants in an experiment were subjected to different conditions in relation to the role of anonymity. The paper contributes to research on social pressure and tax compliance by measuring “(i) the tax evaders’ willingness to pay a fee to avoid publicity of their evasion...and (ii) the taxpayers’ willingness to pay a fee to identify tax evaders.” The authors conclude that “avoiding stigmatisation and social blame is particularly important for occasional offenders.” Furthermore, there is a misalignment between the value attributed to individual anonymity and that of others that can be exploited by tax authorities in framing deterrence strategies.

Choo, C.Y., Fonseca, M.A. & Myles, G.D. (2016) “Do students behave like real taxpayers in the lab? Evidence from a real effort tax compliance experiment.”

The authors report on a tax compliance experiment with three subject pools: students, employees and self-employed taxpayers. They find self-employed taxpayers most compliant, the students least compliant. The experiment bridges two streams of prior research: laboratory experiments and randomised controlled trials. The main finding is that there is a stark difference between students and non-students, which raises important questions about the efficacy of using students for tax compliance experiments.

Hashimzade, N., Myles, G. & Rablen, M.D. (2016) “Predictive analytics and the targeting of audits.”

This paper demonstrates the use of predictive analytics in an agent-based model of a social network that governs the interaction and transmission of information between taxpayers. Taxpayers make an occupational choice between being self-employed or employed, where the latter choice allows no possibility of non-compliance. The predictive analytics use data from tax returns and from the outcomes of past audits, and it is shown that they produce more revenue than a strategy of random audits. One conclusion of the paper is that it may be appropriate for tax authorities to condition audit strategies on both reported income and also occupation.

Manca, M. (2016) “The new Italian cooperative compliance regime.”

The article gives a comprehensive description of a new regime introduced in the Italian domestic tax system as of January 1, 2016. This regime is based on the new approach to the relationship between taxpayers and tax administrations - that of trust and cooperation. The background, as outlined in this article, consists of several projects and initiatives, such as, for example, the OECD framework on cooperative compliance and the OECD Action Plan on BEPS. The Legislative Decree No. 128 (5 August 2015) specifies duties for the Italian tax administration and taxpayers that would help improve transparency and impartiality in tax compliance. The regime will ensure faster domestic ruling procedures and the possibility of reduced penalties when a taxpayer and tax authority disagree in the interpretation of a tax issue. The Decree also refines the boundaries of the judicial doctrine of the abuse of rights which, according to Manca, was often criticised by tax practitioners.

Onu, D. & Oats, L. (2016) ""Paying tax is part of life": Social norms and social influence in tax communications."

It has long been recognized that an individual's tax compliance decisions are often influenced by their social environment. But what exactly do taxpayers discuss and how do their communications lead to changes in compliance? Onu and Oats explore these issues using the discourse analytic approach for an in-depth analysis of online discussions about income tax among software developers. Five broad types of communications have been identified in the sample of 120 conversations: giving and receiving information about tax rules and procedures; communicating social norms of compliance; communicating benefits of compliance; urging to comply by direct persuasion; and warning about penalties or threatening with reputation loss. These findings help to shed light on the process of formation of social norms in tax compliance.

Randlane, K. (2016) "Tax Compliance as a System: Mapping the Field."

In this paper, the author attempts to approach the compliance puzzle in a holistic manner. She provides a systematic analysis of the compliance literature, not only that emanating from economics and psychology but also more recent ethnographic perspectives, in particular Boll (2014); charting its changing focus from deterrence to non-economic considerations. Viewing tax compliance as a system, the author develops an abstract model and suggests we move away from a viewing tax compliance as only being associated with tax evasion towards a comprehensive systems analysis, in order to develop more robust administrative strategies.

Satterthwaite, E. A. (2016) "Can audits encourage tax evasion? An experimental assessment."

This experimental study has investigated dynamic effects of tax audits. How does a taxpayer respond to an audit – does live experience of an audit improve or deteriorate compliance in the future? The economic psychology literature mentions two competing predictions; the "target effect" and the "bomb-crater effect". According to the former, post-audit compliance improves because an audited taxpayer will feel targeted by the tax authority and so will consider themselves to be more likely to be audited in the future. On the contrary, the latter implies that being audited again in the future is less likely, as a bomb is unlikely to hit again the same place, and so post-audit compliance deteriorates. Satterthwaite reports that in this study, based on the survey of 201 U.S. resident workers on Amazon's Mechanical Turk, both effects have been observed, depending on how the audit was framed. Specifically, there was strong evidence of the bomb-crater effect (a drop of 8 percentage points in average compliance rates) after the first audit, which was described as "random" to the participants. However, informing the participants that evasion will trigger future audits according to some "endogenous audit rule" resulted in improved compliance (a 4 percentage point increase). At the same time, while the second audit led to a "dramatically" improved compliance rate, the effect of a string of consecutive audits on average compliance was inconclusive, suggesting that repeated audits might not be cost-effective.

TAX AVOIDANCE

Van der Pas, J. (2016) “Improving the Chinese Anti-Avoidance Rule: A Comparative and Functional Approach.”

The author observes the spread of GAARs and examines developments in China in light of developments in other countries. The paper takes a comparative functional approach that looks not only at the ‘law on the books’ but also ‘law in action’, bringing into the analysis cultural and institutional differences, as well as case law and scholarly opinions. The Chinese GAAR is evaluated by reference to the Netherlands and the UK, and the author finds that while the approaches in these three jurisdictions differ, there are, nonetheless, some common themes. In the Chinese setting, the balancing of taxpayer rights against the interests of tax authorities is ‘easily overlooked’, and the discretionary powers of the Chinese tax authorities lead to an ‘uneven playing field’.

TAX EVASION & CORRUPTION

Alm, J., Martinez-Vazquez, J. & McClellan, C. (2016) “Corruption and firm tax evasion.”

There is a large body of literature on each of the subjects of corruption and tax evasion, yet the relationship between these is not well understood. Corruption, in this paper, relates to the bribing of tax officials and, in particular, the authors consider how the potential for bribery affects firms’ tax evasion decisions. The authors use the World Enterprise Survey, as well as the Business Environment and Enterprise Performance Survey, and use an estimation approach, with propensity score matching as a robustness check. They find that corruption of tax officials is a significant determinant of tax evasion and further that larger bribes result in higher levels of evasion, which underscores the importance of honesty in tax administration.

Litina, A. & Palivos, T. (2016) “Corruption, tax evasion and social values.”

In this paper, the authors propose a theoretical explanation for the relationship between political corruption and tax evasion. They note that the main conclusions of prior literature are that non-evading individuals view tax evasion as immoral and that those with friends who evade tend to do so themselves. The literature also shows that compliance is higher where there is a stronger feeling of social cohesion and that social norms are important in evasion decisions. Amongst other things, the authors conclude that the presumption that trust in tax authorities impacts positively on tax compliance may not hold in societies with a high level of corruption, making it difficult for honest leaders trying to deal with both corruption and tax evasion.

TAX PRACTITIONERS

Finley, A. R. & Stekelberg, J. (2016) “The economic consequences of tax service provider sanctions: Evidence from KPMG’s deferred prosecution agreement.”

The authors investigate whether KPMG’s business of selling tax services suffered after it acknowledged, in June 2005, an “unlawful conduct” in marketing tax shelters to individual clients, and entered a deferred prosecution agreement (DPA) with the Department of Justice. Under the DPA, KPMG was subjected to higher scrutiny during the first three years and agreed to comply permanently with stricter requirements on tax avoidance strategies compared to

other tax service providers. The authors find that after the DPA, the clients were 1.4 times more likely to stop or reduce purchases of tax services from KPMG than from other Big 4 accounting firms. However, the remaining KPMG clients showed no change in tax avoidance behaviour compared to other Big 4 clients. Thus, the sanctioned tax service provider suffered negative economic consequences, whereas there was little or no observable tax cost to the clients who continued to buy tax services from a sanctioned provider.

Frecknall-Hughes, J., Moizer, P., Doyle, E. & Summers, B. (2016) “An examination of ethical influences on the work of tax practitioners.”

This paper addresses two interesting questions arising from the recent debate about the allegedly unethical tax avoidance practices of large multinational companies and the role of tax professionals. The first question concerns the conceptual frame within which tax professionals operate and its effect on the priority given to different ethical considerations. The second question concerns the effect of the tax context on ethical reasoning relative to a more general social context. The Defining Issues Test is used to investigate the use of a consequentialist and deontological approach to moral dilemmas by tax practitioners.

TAX LITIGATION

Freedman, J. (2016) “UK institutions for tax governance: Reviewing tax settlements.”

With the reference to an earlier note by the same author, this article continues a review of the UK tax institutions in the context of sensitive or large settlements. Specifically, the author outlines the issues related to the introduction in 2012 of the post of the Tax Assurance Commissioner and the measures taken towards further enhancement of transparency in the HMRC operations.

INTERNATIONAL CO-OPERATION

Hakelberg, L. (2016) “Coercion in international tax cooperation: Identifying the prerequisites for sanction threats by a great power.”

In October 2014, 51 jurisdictions, including most offshore tax havens, signed a multilateral competent authority agreement (MCCA) under which they resolved to apply, from September 2017, the common reporting standard (CRS) developed by OECD and to set up a peer-review process of monitoring the implementation of the CRS. This article offers an explanation for this major step towards the eradication of tax evasion and tax avoidance. The author argues that this agreement is, in essence, a redistributive cooperation in which there are winners and losers among the participant governments. As such, it was induced by a credible threat of sanctions by a “great power” (defined as a jurisdiction with large internal markets, and less dependent on foreign investment and trade than smaller countries). Hakelberg’s analysis of tax negotiations at OECD level in 1996 - 2014 appears to support two hypotheses about the enforcement of international tax cooperation by sanction threats: (H1) “*domestic constraints preventing a shift of the tax burden from capital to labour or consumption*”, and (H2) “*scope for redistributing cooperation benefitting great power banks or multinationals*”.

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