The evidence

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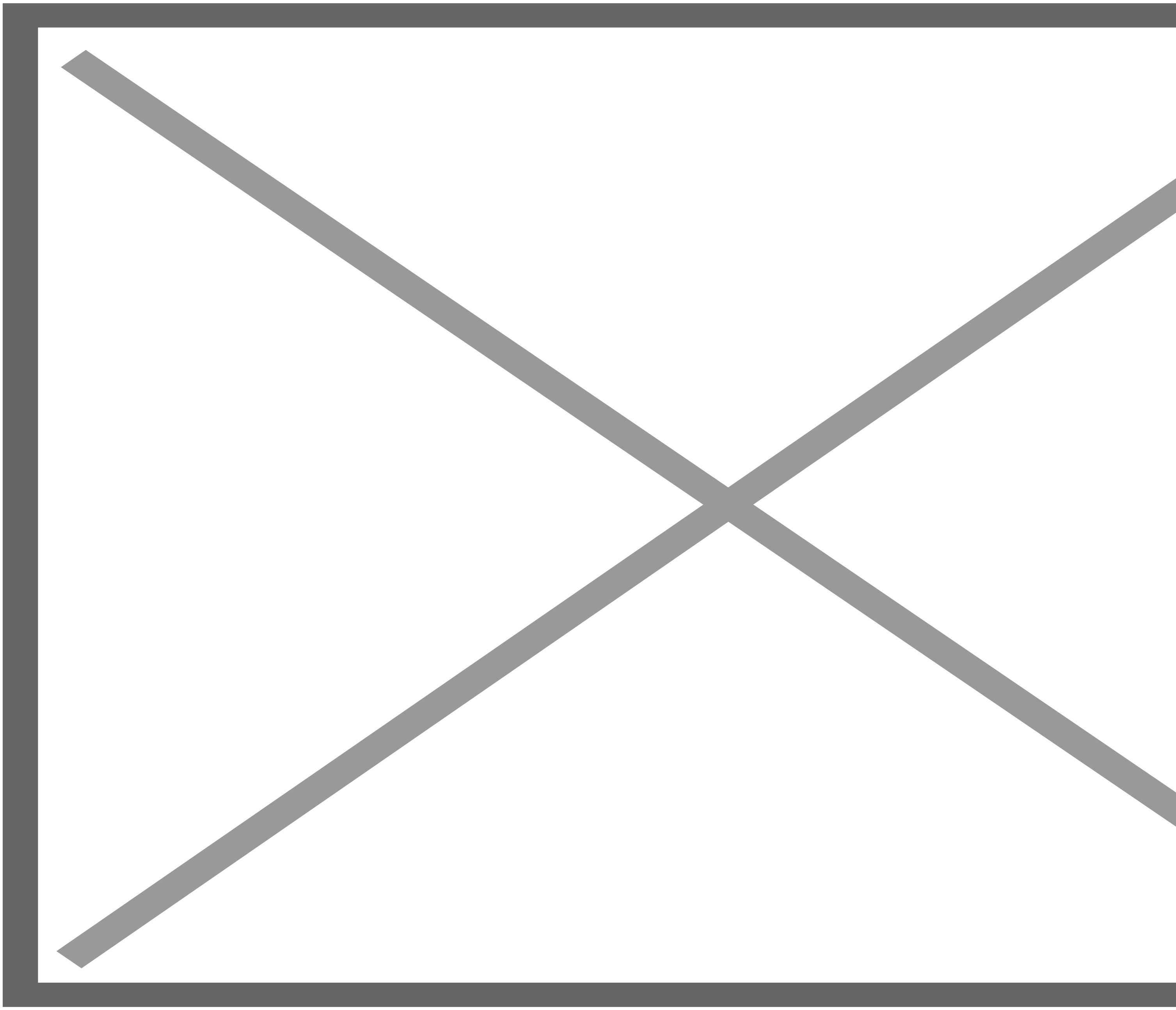

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Diana Onu and *Andy Lymer* consider what psychologists say about tax compliance

Key Points

What’s the issue?

With a clamour for evidence in tax policy setting, what do psychologists bring to the game in terms of understanding tax compliance?

What does it mean to me in practice?

Understanding what motivates tax compliance is key to the generation of an effective tax system

What can I take away?

Psychologists have a lot to contribute to our understanding of taxpayer compliance behaviour – helping us to understand why people pay, as well as don’t pay, their taxes.

Using evidence to inform policy is a key mantra of modern government, not least when it comes to developing tax policy. But where is suitable evidence to be found – particularly with a developing scepticism of experts and of data? This article looks at one aspect of evidence collection from the public–what can and do psychologist researchers contribute to this area on the subject of tax compliance motivators?

Your stance against authority, your personal values, or your regard for the opinions of your loved ones – these are just some of the factors that have been studied by research psychologists trying to figure out why people avoid or evade taxes, or what motivates them to be compliant. This article will take you through some of the main insights from academic psychologists over the last few decades on the subject of what motivates individual tax compliance.

The historical journey starts – funnily enough – with a non-psychologist. In the 1950s, German economist Günter Schmölders published a series of articles where he argued – very much against thinking in public economics at the time – that in order to solve the ‘big’ problems of fiscal policy, psychological and social factors need to be investigated. He speaks of the need to ‘[dig] down deeply into the motivational and emotional layers of the mind of taxpayers and other citizens’ in order to describe people’s ‘tax mentality’.

Schmölders’ work was pioneering in applying theories and methods from psychology and sociology to study economic behaviour; an example of his earlier work is a series of surveys looking at the ‘tax mentality’ of both the West German public, and the members of Parliament (Bundestag). Some of the more eye-catching insights from these surveys were that members of the public ‘compared tax-dodgers neither with criminals nor with common-sense folks, but with clever business men’. Also were his heavily critical opinions of politicians following the survey of Bundestag members and, in particular, the finance committee. He described the answers as betraying ‘very little understanding of fiscal-monetary relations’ and a reliance on emotional language and ‘catchphrases’ little related to facts. He writes: ‘It seems, therefore, of little use to confront our politicians with issues of such complex nature as the fiscal-policy program. Such issues will have to be broken down into simple, elementary truths and impressive formulas of action before politicians are asked to decide on them. […] The new branch of fiscal psychology seems to fit to help understanding and preparation for such a task’. Schmölders’ work (along with George Katona in at the University of Michigan in the US) reflected a need for the inclusion of psychological factors in the study of tax policy, a field he described as ‘fiscal psychology’. Unlike many branches of psychology and economics which are heavily dominated by US researchers, fiscal psychology (and economic psychology in general) still has a very strong presence in European research still today.

Fiscal psychology began to be explored in greater earnest in Britain in the 1970s. In an article published in the British Journal of Social Psychology in 1982, Alan Lewis from the University of Bath argued for the need to further develop the interdisciplinary branch of fiscal psychology. Many of the issues he was concerned with are surprisingly current today. He reported, for example, in the late 1970s, he found that the British public generally supported a progressive tax rate (but with a lower marginal tax rate). However, this 'general preference' seemed somewhat different from 'personal preference', where 70% of Scottish taxpayers believed they paid too much tax compared to other people. Lewis' survey of the public also found widespread support for public expenditure programmes such as pensions and healthcare, but relatively less so for welfare spending towards those seen by some members of the public as 'the un-deserving poor' and portrayed by certain media as 'scroungers', particularly following periods of recession (a societal landscape still familiar 40 years on!). Interestingly enough, he brings up the question of whether 'fiscal referenda' (referenda on tax rates or tax structure) would be a way to involve the public in the tax debate but does ask whether referenda, 'the mere aggregation of preferences, some ill-considered, [could constitute] a substitute for reasoned debate'. (This idea was further explored in the article written by Andy Lymer in *Tax Adviser* in December 2015 on Public Attitudes to tax.)

The use of surveys of public opinion to inform tax policy became more widespread in Europe and the US in the 1970s and 1980s, motivated by the recognition taxpayers' cooperation is essential for building functional welfare states, and that this cooperation is contingent on psychological factors. However, insights from these surveys were not without criticism; in particular, the extent to which one can trust findings based on people's reported tax compliance. Surely, many survey respondents wouldn't report behaviour that is not only socially undesirable, but also illegal, to a stranger conducting a survey?

To look into this issue, Dick Messing and colleagues from the Erasmus University in Rotterdam had the unique opportunity to work with the Dutch tax authority and compare taxpayers' documented status with the tax authority to their responses to a tax compliance survey. They found there was *no relationship* between people's compliance as reported in the survey and their compliance status with the tax authority! To overcome this shortcoming of surveys some looked to how to improve data gathering techniques from surveys, others looked at other research approaches. For example, several psychologists working on tax compliance began using laboratory experiments. Participants in experiments would come into the laboratory and play different 'tax games' where the tax compliance decision is investigated by using 'simulations' of the real behaviour. For example, a notable research centre to use experiments in studying tax compliance developed in the 1990s at the University of Exeter, including prominent economic psychologists Paul Webley and Stephen Lea.

Despite developments outlined above, psychologists' voice has been marginal in debates on tax compliance until relatively recently. The understanding of tax compliance relied heavily on an economic understanding of taxpayers as rational actors who seek to maximise personal profit, and who will always evade if they perceive a large payoff with a low likelihood of being caught. This view informs a *deterrence approach* to tax by which tax authorities focus on large fines and frequent checks. By contrast, a psychological understanding of taxpayer motivations informs a *cooperative approach* to taxpaying, focus on treating taxpayers fairly, making it easy to comply, and promoting a cooperative climate. Many debates in the field focused on the opposition between the *deterrence approach* and the *cooperative approach*.

In the 2000s, significant contributions from psychologists emerged from the Centre for Tax System Integrity at the Australian National University. Rather than focusing on the dichotomy between the deterrence approach and the cooperative approach, much of the work carried out at the centre related to the concept of *responsive regulation* which promoted the idea that different types of taxpayers should be faced with different approaches: the compliant majority with cooperative measures while the non-complaint majority with tough deterrence measures (the regulatory model that this led to in the Australian Tax Office). Much of the centre's work focused on ways to increase voluntary compliance through measures such as fostering positive taxpaying norms and ensuring taxpayers are treated fairly.

Another popular model that integrates the deterrence approach and the cooperative approach was developed at the University of Vienna, a key centre for tax psychology in the last decade, under the leadership of Erich Kirchler. The ‘slippery slope’ framework presents a model by which high rates of compliance can be achieved through either the deterrence approach (through the perceived power of authorities) or the cooperative approach (through building trust in authorities). While they are both effective at revenue collection, the former is more costly to enforce and maintain in the longer term. However, while the cooperative approach may seem desirable, trust in authorities is very difficult to build, especially in low-trust climates. Researchers at the University of Vienna focus on understanding the conditions that help build and maintain a trust-based tax compliance climate.

Research developments in the psychology of tax compliance provides significant evidence that psychological factors can play an important role in tax compliance; however, the magnitude of this effect and circumstances under which these factors are important are still to be determined by ongoing research. Nonetheless, these research developments are increasingly taken into consideration by tax authorities around the world. For example, HMRC periodically carries out a large survey of individual and businesses monitoring changes in psychological variables, such as people’s perceived social norms relating to tax and their ratings of tax fairness. Moreover, psychological insights are increasingly used by governments in designing behaviour change (‘nudge’) campaigns to increase tax compliance – but such campaigns will be the focus of a later article.