



Tax Administration
Research Centre

(Non)compliance motivations

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[with thanks to Prof Lynne Oats and Prof Gareth Myles]

Overview

1. Introduction & Tax Administration Research Centre
2. Taxpayer motivations research – what motivates people to comply, avoid, or evade?
3. Avoidance and high income individuals
4. Motivations in interaction – looking at actual discussions between taxpayers & public attitudes on avoidance
5. Discussion

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Tax Administration Research Centre (TARC)

TARC – University of Exeter

£2.5m for five years provided by the HMRC/HMT/ESRC to Exeter-IFS partnership

Aim: “to support high quality research and related activities on tax administration with a view to strengthening the theoretical and empirical understanding of the delivery and design of tax operations and policies”

Launched Jan 2013

Introduction

Compliance
motivations

Avoidance and
high earners

Motivations in
interaction

Discussion

Tax Administration Research Centre (TARC)

TARC research - four themes:

- 1. Analysis and Simulation**
- 2. Estimation and Evaluation**
- 3. Economic and Social Experimentation**
- 4. Interdisciplinary Qualitative Analysis**

Network of international fellows & visitor programme

Organises conferences, workshops, Master classes
Journal of Tax Administration

**Potential for collaboration regarding future avoidance research
and programmes?...**

Details: tarc.exeter.ac.uk

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Compliance motivations

avoidance

compliance

tax planning

evasion

over-compliance

**committed
compliance**

**capitulative
compliance**

**creative
compliance**

**non-
compliance**

(Kirchler & Wahl, 2010; McBarnet, 2001)

Your definitions

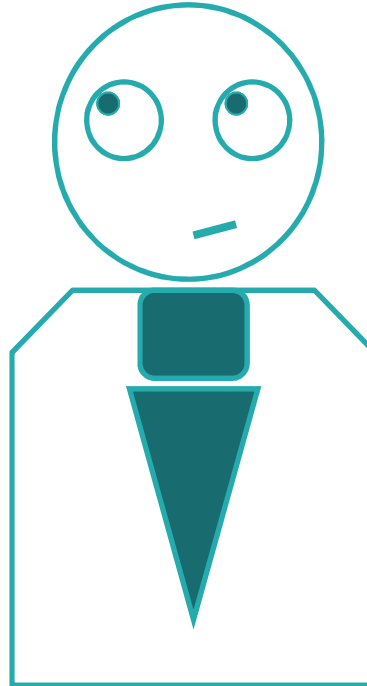




Social norms

Public good contribution

Cooperative compliance



Tax morale

Motivational posture



Monetary penalty

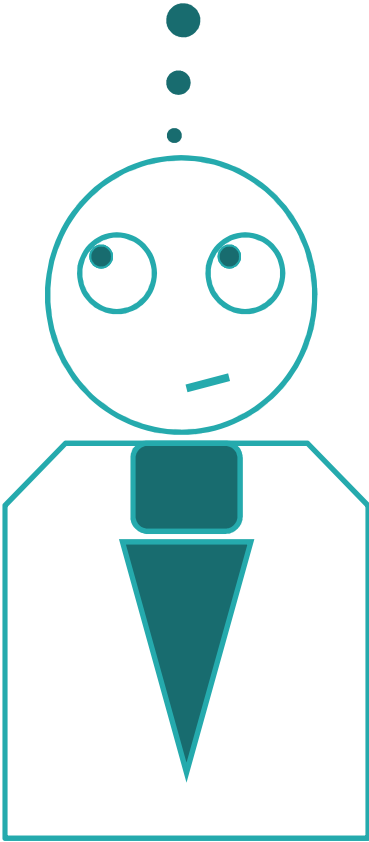
Reputation loss



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Compliance – classic model

Non-compliance as a *gamble* - taxpayer is gambling on not being audited and discovered (Allingham & Sandmo, 1972)

Taxpayer has income Y and declares income X , with $0 \leq X \leq Y$
Income when not caught is:

$$Y^{nc} = Y - tX$$

If the fine is F then income when caught is:

$$Y^c = [1 - f]Y - F[Y - X]$$

If income is understated the probability of being caught is p

Applying expected utility theory implies the optimal declaration X solves

$$\max_{\{X\}} E[U(X)] = [1 - p]U(Y^{nc}) + pU(Y^c)$$

Compliance – classic model

Solving: finding the optimal income X^* to be declared by the taxpayer

Solution: optimal income declared when $p < 1/[1 + F]$

When $F = 1$ the taxpayer will evade if $p < 1/2$

The model predicts that for realistic parameter values *every taxpayer should be non-compliant*

Classic model - criticism

In the orthodox model the taxpayers use the objective probability of audit and know the fine

Two criticisms:

the probability is not public information
the fine is not widely known

In reality, people form *subjective beliefs* about audits
(Hashimzade, Myles, Page, & Rablen, 2013)

Best practice – not to disclose real audit probability...

Practical considerations

Tackling beliefs about expected utility

Case study

Real life: expensive mistake

Tax avoidance schemes are expensive and tax avoiders cannot count on being able to recover their fees and other costs when a scheme fails to deliver. For example, in the case of *Brown v InnovatorOne plc* ([2012] EWHC 1321 (Comm)) the claimants took action against the promoters of 19 failed tax avoidance schemes, which set out to abuse tax reliefs intended to encourage investment in information and communication technology. When their action failed in the High Court, the judge pointed out that not only did they not get the tax result they wanted, but they had also inadvertently exposed themselves to a liability of four times the amount of money they put into the schemes.

Case study

Real life: penalties and interest

An individual who had made a large capital gain used a tax avoidance scheme which was supposed to reduce his tax bill to zero by creating an artificial tax loss. He paid more than **£270,000** in fees to the promoter to use the complicated arrangements required by the scheme. An in-depth investigation by HMRC showed that transactions which were supposed to have taken place had not in fact been carried out as claimed. In the event he had to pay more than **£95,000** interest and penalties on top of all the tax he had tried to avoid. Many people used this particular scheme and also had to pay substantial penalties.

Beliefs about being challenged

Avoidance

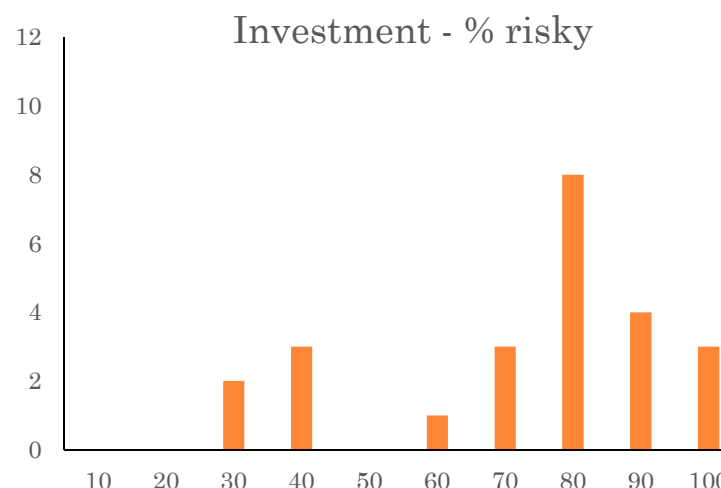
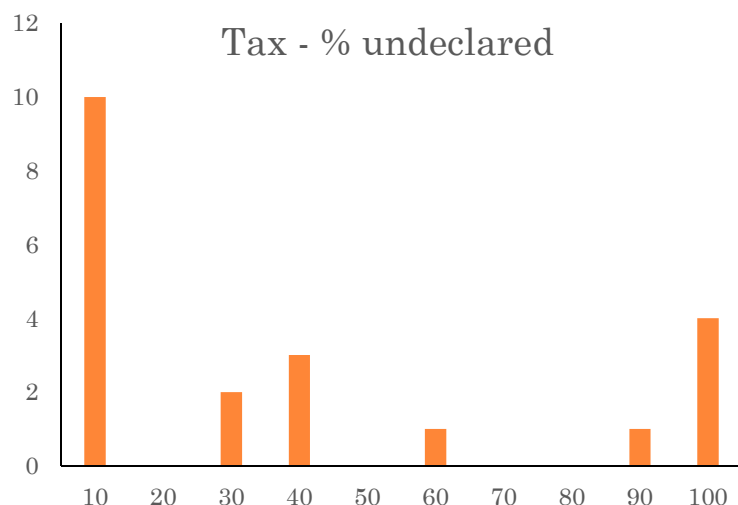
HMRC has won more than 50 tax avoidance cases since 2010, with billions of pounds at stake.

HMRC has initiated more than 30 changes to tax law since 2010, closing down numerous avoidance loopholes.

Tax compliance as social practice

Participants took part in a TARC experiment

2 versions, same payoffs – ‘tax’ version and ‘investment’ version



Tax compliance – more than a gambling decision!

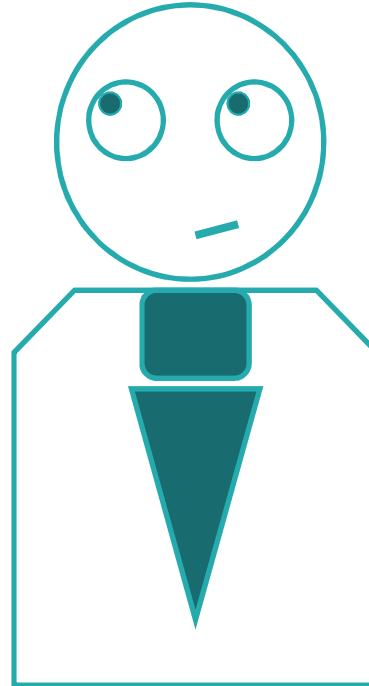
See also: Choo, Fonseca, & Myles (2014) on tarc.exeter.ac.uk



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Stigma costs

Some taxpayers will always be fully compliant

This can be explained by a social custom

If the social custom is broken there is an additional loss of utility (stigma cost) (Myles & Naylor, 1996)

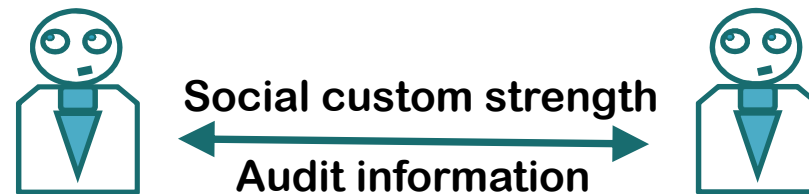
Details first published 20.05.14

Name	Business, trade or occupation	Address	Default dates	Penalty amount £	Total amount of tax/duty on which penalties are based £	Other Information
Mr F J Graham	Farmer	9 Caherty Road Sroughbane Ballymena County Antrim BT42 4QA	06/04/10 - 05/04/11 06/04/11 - 05/04/12 06/04/11 - 05/04/12	£8,625.37 £1,434.41 £ 131.73	£23,470.40 £ 4,039.22 £ 355.47	
Mrs T M Martin	Publican	95 Duke Street Formby Liverpool L37 4AR	06/04/10 - 05/04/11 06/04/11 - 05/04/12 06/04/12 - 05/04/13	£20,045.47 £19,975.27 £ 7,292.02	£28,697.00 £28,593.00 £10,803.00	
Waterloo Leisure Ltd	Other Recreational Activities	Formerly of 125 Alaska Street London SE1 0XE	01/05/10 - 31/07/10 01/08/10 - 31/10/10 01/11/10 - 31/01/11 01/02/11 - 30/04/11 01/05/11 - 31/07/11 01/08/11 - 31/10/11 01/11/11 - 31/01/12 01/02/12 - 30/04/12 01/05/12 - 31/07/12 01/08/12 - 31/10/12 01/11/12 - 31/01/13 01/02/13 - 30/04/13	£32,369.28 £31,682.03 £32,679.13 £34,780.60 £34,854.74 £35,025.48 £35,162.99 £35,459.50 £35,527.54 £34,737.77 £33,943.63 £32,564.65	£62,660.00 £63,010.00 £65,458.00 £70,056.00 £70,437.00 £70,820.00 £71,207.00 £71,596.00 £71,988.00 £72,382.00 £72,779.00 £73,179.00	Trading as Pleasurezone
Savvy Le Chill Limited	Physical Wellbeing Activities	Formerly of Flat 39 Lowry Court 5 Stubbs Drive London SE16 3ED	01/06/10 - 31/08/10 01/09/10 - 30/11/10 01/12/10 - 29/02/11 01/03/11 - 31/05/11 01/06/11 - 31/08/11 01/09/11 - 30/11/11 01/12/11 - 29/02/12 01/03/12 - 31/05/12	£3,769.35 £4,556.17 £5,131.42 £5,709.60 £6,178.57 £6,748.65 £7,409.52 £7,716.15	£3,866.00 £4,673.00 £5,263.00 £5,856.00 £6,337.00 £6,922.00 £7,599.00 £7,914.00	

Tax defaulters 'name and shame' list

Modelling taxpayer behaviour

Agent-based model – simulation of taxpayer interaction in a virtual population of taxpayers (Hashimzade, Myles, Page, & Rablen, 2013)



- Information transmission can sustain a subjective probability above the objective probability
- Attitudes can differ among occupational groups
- Compliance can be increased by fostering attitudes

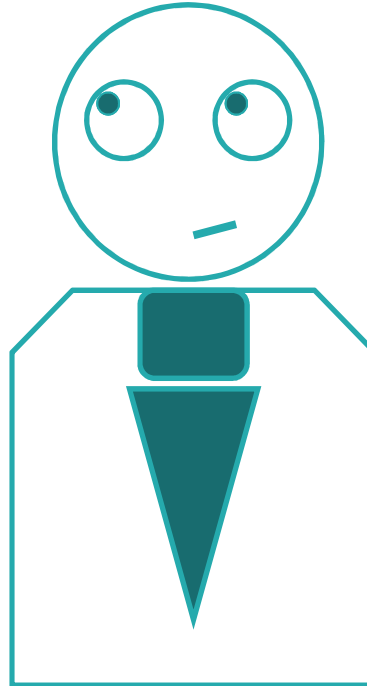
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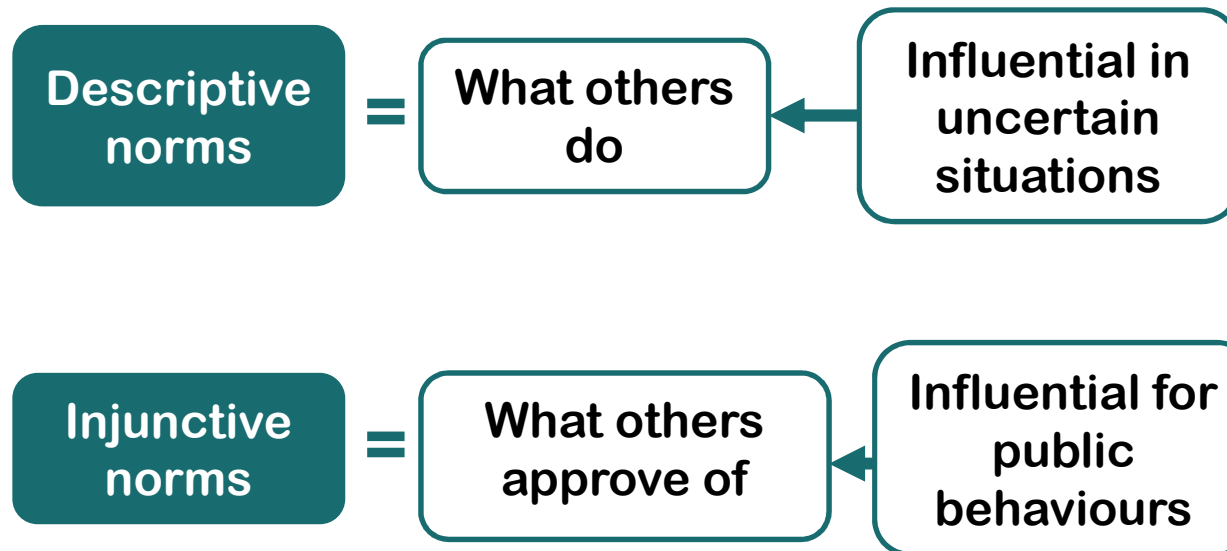
Social norms and tax compliance

Survey work – social norms within the taxpayer population and occupational group (e.g., Wenzel, 2004; Torgler, 2005; Ashby, Webley, & Haslam, 2009)

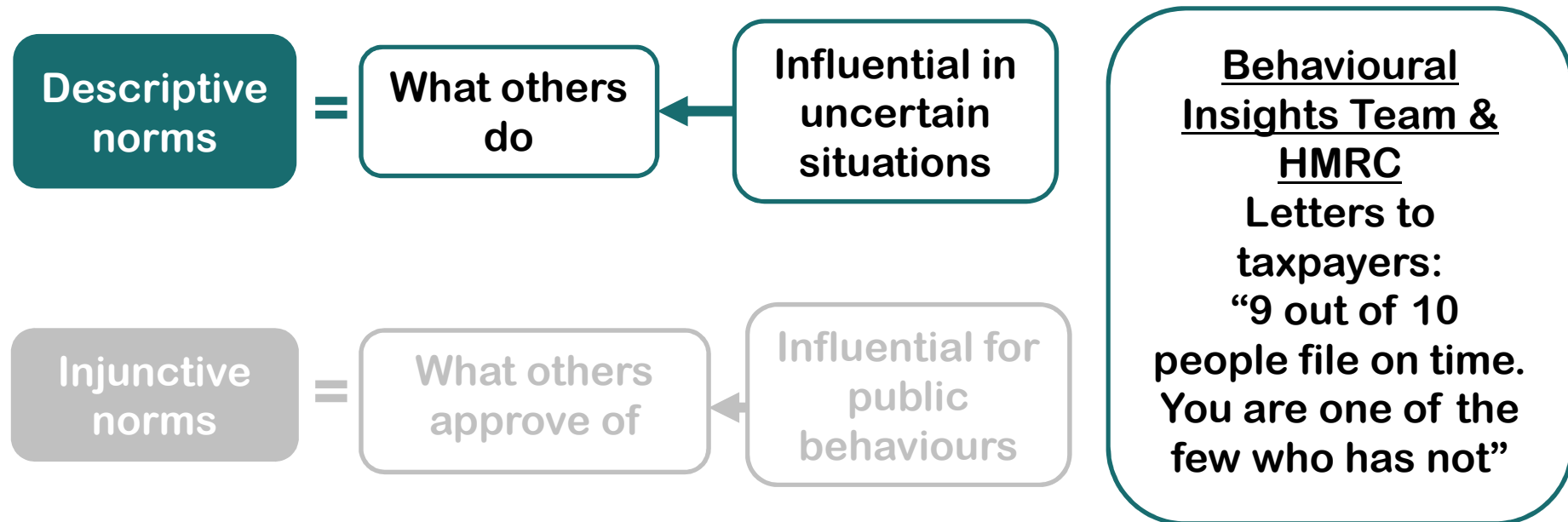
Experimental evidence of social norms importance (e.g., Bosco & Mittone, 1996; Alm, McClelland, & Schulze, 1999)

Recent interest from tax administrations – survey and interview studies on social norms (e.g., HMRC, 2009, 2010; NTA, 2013)

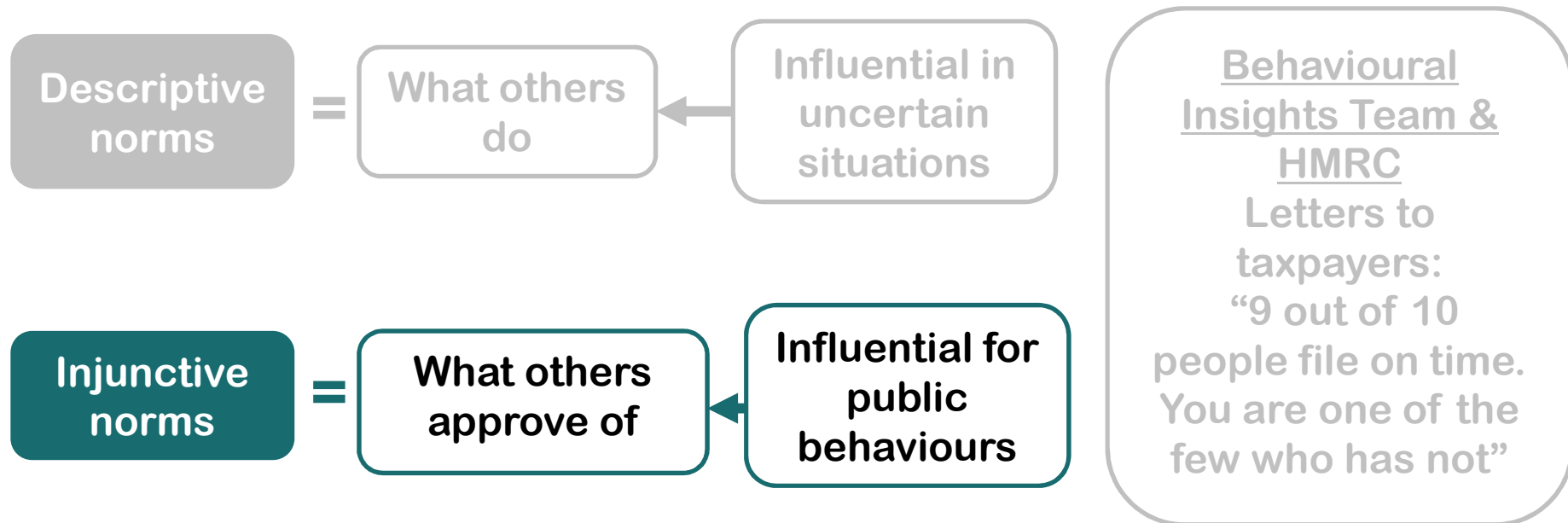
Social norms - types



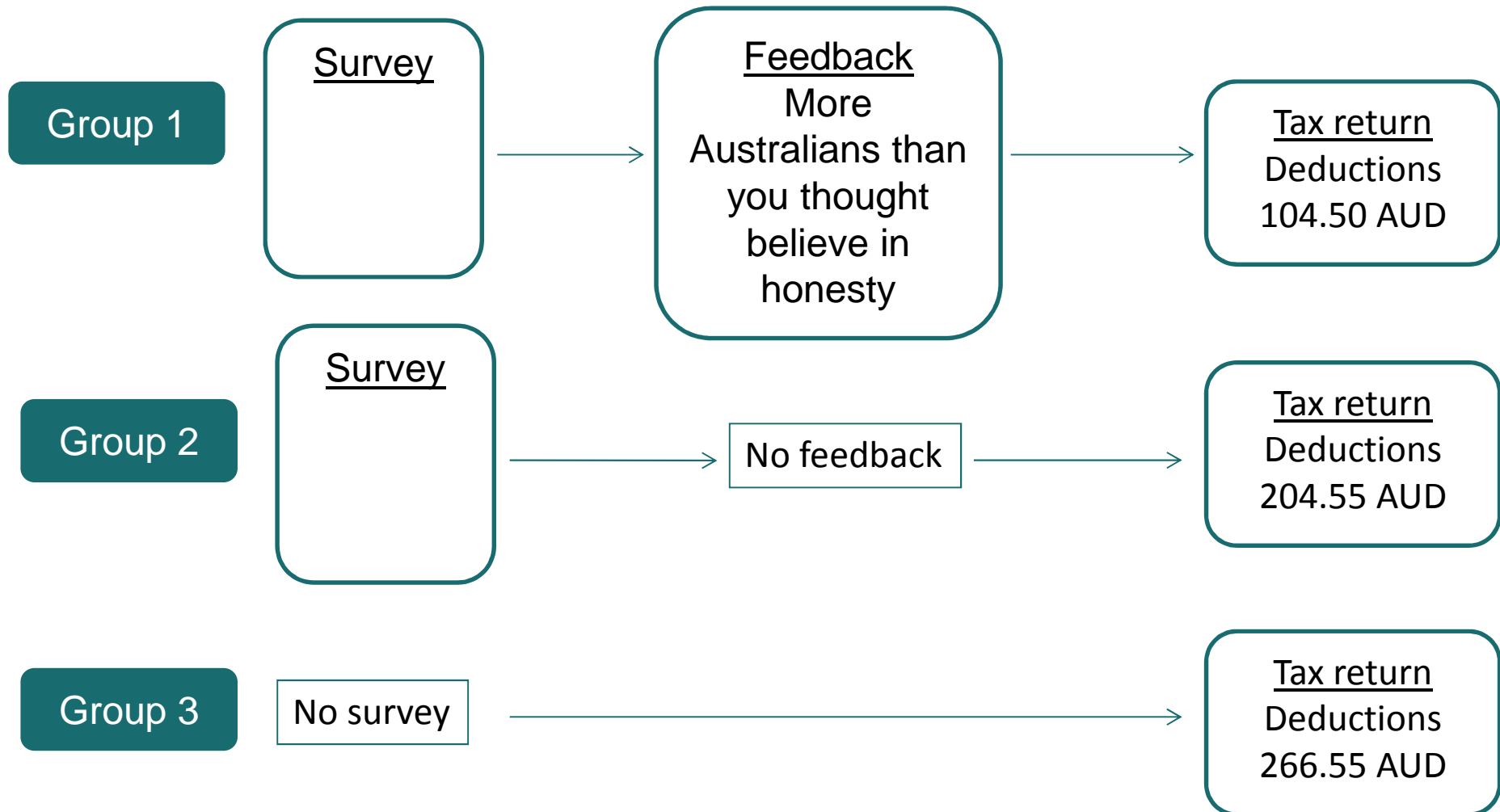
Social norms - types



Social norms - types



Wenzel, 2005



Whose social norms?

Most work – norms in national groups

Importance of group identification – people will only follow the norms of groups they identify with
(Ashby, Haslam, & Webley, 2009; Wenzel, 2004)

Some authors call for appeals to ‘good citizenship’ identity to increase compliance (e.g., Alm & Torgler, 2011; Wenzel, 2007)

National identity compliance campaign

WW2 US cartoon – ‘The New Spirit’ (1942)

EMBEDDED VIDEO NOT AVAILABLE IN
THE ONLINE VERSION.

PLEASE SEE THIS VIDEO AT:

<http://www.youtube.com/watch?v=00u6qUelp6c>

Whose social norms?

Norms in other groups than nations may be more relevant to the individual

Norms in occupational groups – people are ‘socialised’ to pay tax in certain occupational cultures (Ashby & Webley, 2008)

Norms of town/region may seem more relevant than national norms

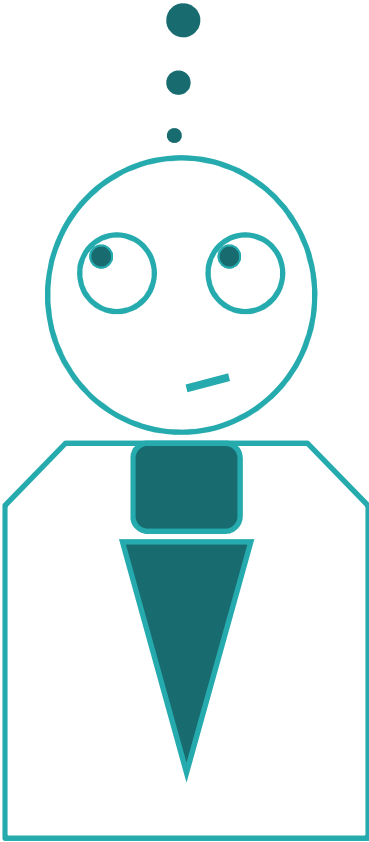
Taxpaying norms of different income groups?...



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Tax as public good

Tax compliance as social dilemma – everyone is better off having the public good, but they would all like to avoid contributing

Several experiments framed tax ‘games’ as public good games – people contribute to the group (tax); their contributions are multiplied and shared among group members

People’s perceptions of fair distribution and fair returns are likely to increase compliance (Frey, Benz, & Stutzer, 2004)

Swedish campaign for younger taxpayers

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THE ONLINE VERSION.

PLEASE SEE THIS VIDEO AT:

<http://www.youtube.com/watch?v=y3hd4CKGY98>

ATO – Is this fair?

EMBEDDED VIDEO NOT AVAILABLE IN
THE ONLINE VERSION.

PLEASE SEE THIS VIDEO AT:

<http://www.youtube.com/watch?v=K6W9CaABoXQ>

Agency in public good spending

People show more cooperation in tax public goods games when they are allowed to vote (Feld & Tyran, 2002)

When they were able to communicate, people agreed and voted for a higher enforcement regime (Alm, McClelland, & Schulze, 1999)

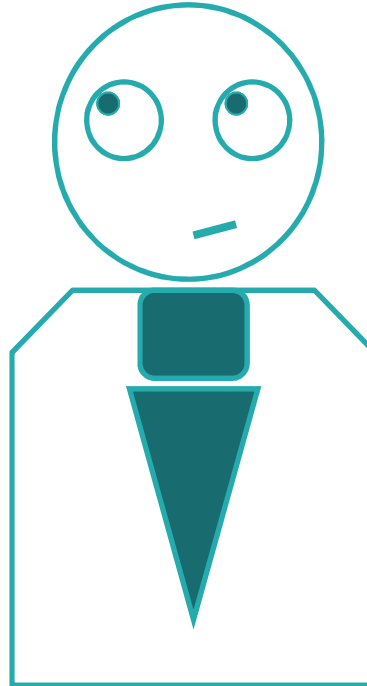
Direct democracy – one explanation for Switzerland's very high tax morale (Alm & Torgler, 2006)



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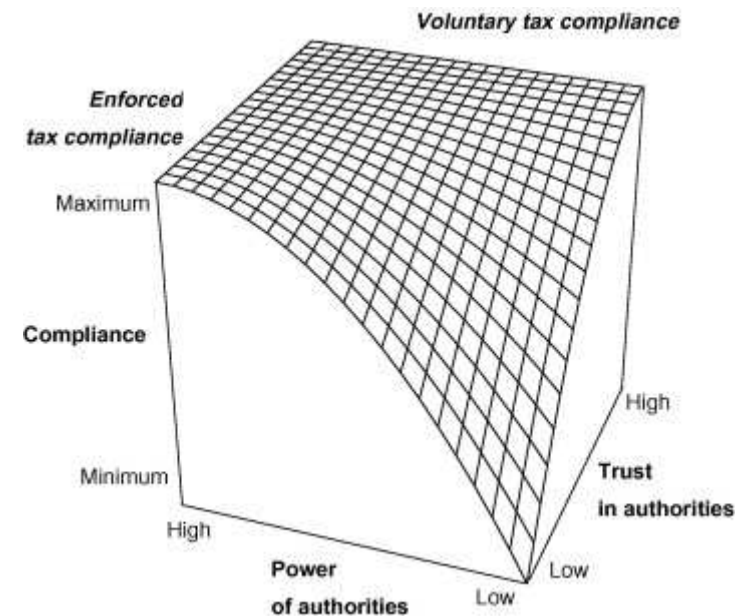
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Relationship with tax authority

Perceiving to be treated fairly by the tax administration increases taxpayer compliance (Kirchler, Hoelzl, & Wahl, 2008; Wenzel, 2003)

Includes a 'customer-focused' approach

- ease of understanding the rules
- ease of payment

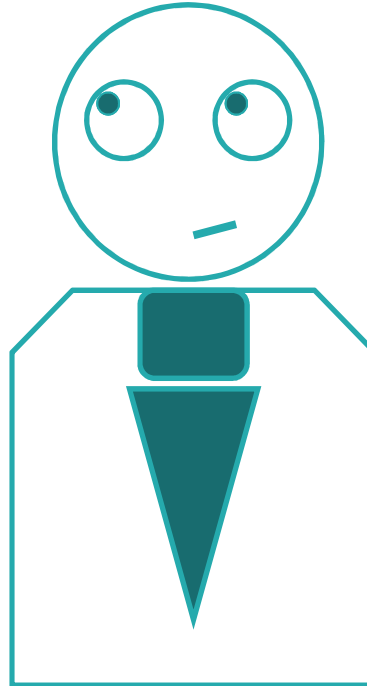




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Tax morale

‘intrinsic motivation to pay taxes’ (Torgler, 2005)

‘moral obligation’; ‘belief in contributing to the society’

Used to investigate cross-country differences in taxpaying attitudes (e.g., Alm & Torgler, 2006; Cummings, Martinez-Vazquez, McKee, & Torgler, 2006; Torgler, 2005)

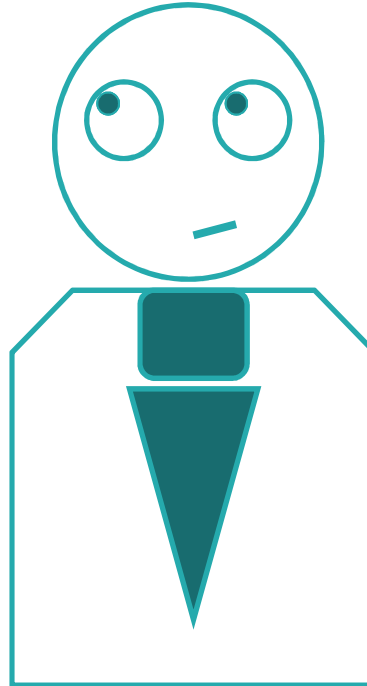
Criticism: vague concept; not easily malleable.



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Motivational postures

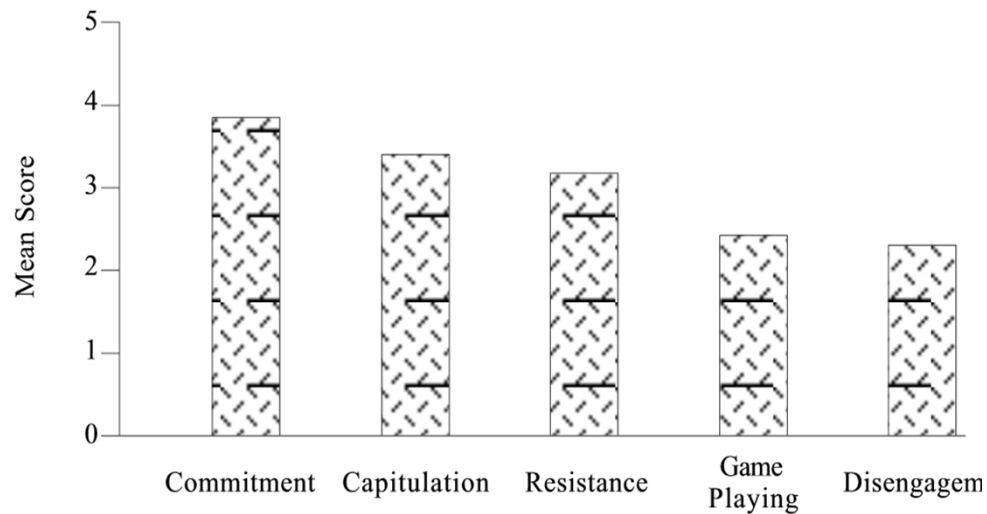
Based on people's general stance towards authority

5 motivational postures (Braithwaite, 2003, 2009):

1. Commitment ('Paying tax is the right thing to do')
2. Capitulation ('No matter how cooperative or uncooperative the tax office is, the best policy is to always be cooperative with them')
3. Resistance ('It is important not to let the tax office push you around')
4. Disengagement ('I don't care if I am not doing the right thing by the tax office')
5. Game playing ('I like the game of finding grey areas in the tax law')

Motivational postures

Repeated surveys of Australian taxpayers, 2000, 2002, 2005



Source: Braithwaite, 2003

GROUP DISCUSSION

Which compliance factors are relevant to the typical taxpayer you target? Are these relevant for scheme proponents? Which?

Which factors are not as relevant? Why?

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Game playing

Motivational posture towards tax office or tax system
(Braithwaite, 2009)

Appears as a consequence of authorities focusing on non-compliance and 'quick wins' rather than strengthening the law and compliance attitudes

Endorsed by 13% of Australian survey respondents, although fewer than that have the resources to act upon these attitudes

Game players – a profile

Game playing was positively associated with:

- **‘The tax system should be abolished’**
- **Preference for an aggressive tax practitioner**
- **Individuals who value: wealth, influence, and social status**
- **People who believe in free markets and small governments**

! Important to remember these are attitudes not behaviour

Avoidance vs Evasion and Compliance

Economic psychology – interest in disentangling evasion from avoidance (Kirchler & Wahl, 2010)

4 scales (lists of 8-10 questions) to measure:

- 1. Voluntary tax compliance (pay tax to contribute)**
- 2. Enforced tax compliance (pay tax because of audits/fines)**
- 3. Tax avoidance (reduce tax legally)**
- 4. Tax evasion**

Uses fictitious scenarios rather than direct questions

Tax avoidance correlated with the postures of game playing and resistance

Psychological research on avoidance is in its infancy!

High income earners

Inconclusive past results regarding compliance and income
(Andreoni, Erard, & Feinstein, 1998)

Different income categories may react differently to compliance campaigns:

Minnesota Tax Experiment (1996), two interventions:

- 1. Increase in audit probability**
- 2. Social norms message**

While interventions increased declared income for low- and middle-income taxpayers, they *decreased* declared income for high-income taxpayers

(Blumenthal, Christian, & Slemrod, 2001; Slemrod, Blumenthal, & Christian, 2001)

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Studying naturalistic interaction – Online discussions

User1: Am I supposed to be paying tax from my freelance design services?
I'm not at the moment. lol

User2: [...] Honestly, it really isn't as complicated as a lot of people make out as long as you keep a record of all your incomings and outgoings, and certainly isn't worth risking getting caught not declaring income. [...]

User3: [...] you need to register as self employed or the HMRC will take you to the cleaners LOL!

User4: Broadcasting that on a public forum isn't the smartest idea. HMRC have internet access too you know?

User1: Thank you for the helpful stuff guys.
[in direct response:] There's no chance of them finding me, Andrew isn't even my name. They know nothing about me.

User4: It doesn't matter what your name is. If your not paying tax, as you previously admitted, then it is only a matter of time before they find you and recover what is owed. 💣

User1: You have to declare in the first 3 months, I have. I am now paying tax.

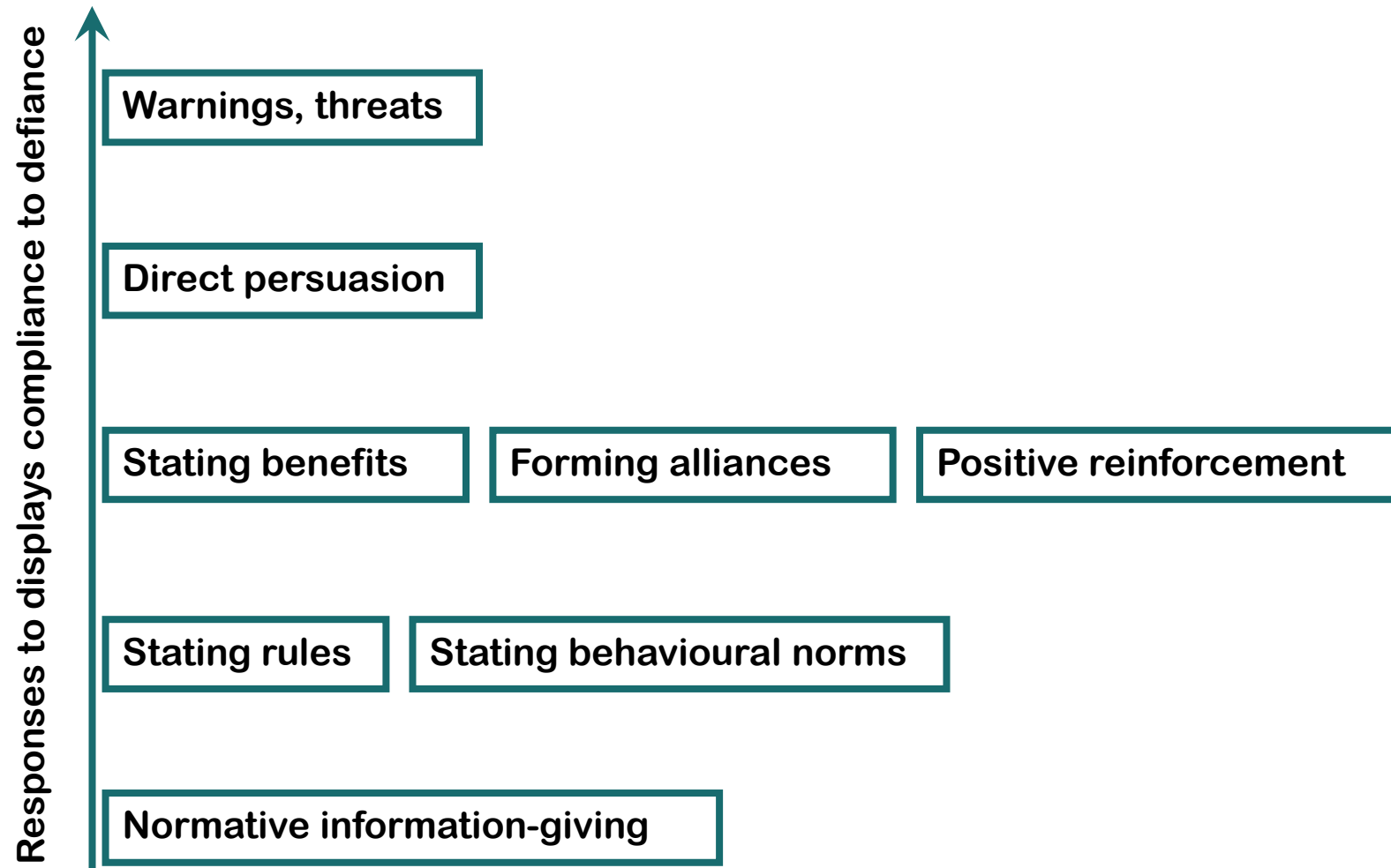
Study - Onu & Oats, 2014

Selected and analyzed online discussions between IT consultants

Focused on discussions where compliance decisions are involved: to register or not with tax authority, to declare online income, to overstate expenses

Analyzed how people attempt to convince others to comply or not

Results – social influence actions



Implications

Analysis offers realistic account of taxpayer interaction

By-passes issues of desirable responses in interviews and survey, or abstract theory-driven methodology

Informs the types of persuasion messages people use in day-to-day communication

Can indicate which messages are most persuasive

(1) Discussing tax avoidance

Online environment – where people go to for information

Selected discussions from larger dataset – forums for contractors, small businesses, etc.

Selected those using “tax avoidance”

Issues discussed: IR35, VAT disaggregation, offshore subsidiaries to avoid income tax, current high profile avoidance cases

Discussing tax avoidance

Types of discussions:

1. Making sure one's affairs are legal – people seek information about how to stay compliant

I currently work at a Temp agency, where they have placed me at a company for the last 3 months. This company want me to carry on working for them for the foreseeable future and told me to look into forming my own limited company.

However, I would still be getting paid by the agency, as the company I'm at won't directly employ people. **So what I'm worried about is falling foul of the IR35 legislation.**

Discussing tax avoidance

2. Communicating about means of avoidance

User 4:

Hi all, I'm just planning to start a new web-based venture locating the new company in a low-tax jurisdiction such as Ireland (most probably), or Cyprus or the Isle of Man. Can someone please give some advice on how to benefit from UK double tax treaties with the above countries given that a UK non-trading/holding company will own 51% of the shares of the new company. The UK holding company itself is fully owned by BVI companies and the director is UK resident. Many thanks in advance for your help!

User1:

Hi, This sounds interesting. Please let me know if you found out anything? Thanks

User4:

investment holding shares in a trading irish/cypriot company (12.5%/10% worldwide income taxation). The goal is to have worldwide profits taxed in a favourable, and still reputable, jurisdiction like Ireland or Cyprus (both EU countries) and then distribute dividends to UK holding with no additional tax liabilities (i.e. withholding taxes). I will be looking for professional advice on this matter, even if I thought someone here is already using such corporate vehicles. They seem so popular online. Cheers

Discussing tax avoidance

3. Exploring 'gaps' and fixes in tax planning

Are there any flaws in this structure? Can it be considered tax avoidance by HMRC?

User 4:

Who runs the offshore company?

User1:

What would be tax implications if I was the director? What would they be if that was someone else and I would only be a 100% shareholder?

User4:

I didn't ask who was going to be the director. I asked who was going to run the company - make the management decisions and control its operations. A cynic would infer from your response that you want to know what the correct answer to the question is before you give it.

User1:

I will run the company.

Regarding the dividend received by UK company from abroad - is dividend received from a US company exempt from taxation?

Discussing tax avoidance

4. Discuss legislation

5. Selling services

User1:

Hi, I was wondering if anyone had any experience or advice for moving a company offshore? ... For these reasons we are looking to register the company offshore so we can benefit from reduced taxes etc.. There seems to be a lot of different options, such as Isle of Man, British Virgin Islands, Cayman Islands etc.. but we're not sure which would be the best or the the most secure. If anyone has any tips or advice on the pitfalls or benefits it would be much appreciated. Thanks,

User2:

Hi there,

This is a complicated question with a multitude of pitfalls for the unwary. Can I suggest that you PM me with your contact details and I'll have a chat with you?

Discussing tax avoidance

6. Discuss tax avoidance in high-profile cases

User1

I see that Amazon pays no corporation now tax because it has transferred ownership of the Amazon.co.uk site to Luxembourg, it has classed itself as a distribution center . So along the same lines, I am now thinking about opening a Fish & chip shop takeaway , Sorry I meant a oceanic creature & root vegetable distribution center ,

User2

It's called Tax Avoidance.

User3

Amazon, like most listed companies, has a mandate from shareholders to maximize efficiency in regards to their treasury function. You'll find most large listed companies operate tax efficiencies along similar lines.

User4

They do pay corporation tax. They just don't do it in the UK. My company makes sales to about 30 countries, but we only pay corporation tax in one.

User5

I'm sure you know full well that if you or I were to attempt any such creative accounting then HMRC would be jumping up and down on our heads.

Some insights...

Online communication seems to both encourage and undermine compliance

Discussions much more technical than evasion discussions

Very little mention of right or fair – unless it's a public figure!

Avoidance as individual issue...

Morality

Jimmy Carr and [#k2](#) tax avoidance scheme - he is a hypocrite and that's official - shame on him

Legality

I don't understand why everyone is hating on [#JimmyCarr](#) the **K2** is legal, maybe immoral, but he pays his taxes like the rest of us.

Jimmy Carr did nothing wrong and I would back him 100%. The worst thing he did was back down and stop using this **K2** system.

Fairness

[#JimmyCarr](#) at A&E the other day: "Come on Come on what's the hold up? Is this what I nearly pay my taxes for!"

Public attitudes towards avoidance



Twitter, June 20-31, 2012

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Avoidance as societal issue...

Politics

David Cameron says Jimmy Carr using K2 Tax scheme is "morally wrong". Gary Barlow used similar scheme - make him give his OBE back!

Institutions

Are HMRC 'too scared' to sue Jimmy Carr and other K2 tax avoiders?

Societal symptom

Jimmy Carr has done what most property tycoons, mp's, entrepreneurs and most business people do to avoid tax the "k2" scheme #taxdodgers

Model

@jimmycarr I think your a genius for using the K2 scheme. Haters are just jealous that you have the brains they didn't. #genius

Public attitudes towards avoidance

Would you do a Jimmy Carr?		
Tax evasion	I'd break the law (eg, cash-in-hand)	10%
Tax loopholes	I'd push as far as possible, Jimmy Carr-style, as long as legal.	45%
Tax avoidance	I'd do what I could to reduce tax, without taking the mickey	31%
Tax planning	I'd only use vehicles such as Isas & pensions, that the Government encourages	14%
21,832 votes received		

Poll on MoneySavingExpert.com, July 2012

Public attitudes towards avoidance

Such events shape public opinion

- Opportunity to condemn avoidance**
- But also create a norm of noncompliance = ‘this is what successful people do’**

Politically divisive, undermines trust in institutions

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FINAL DISCUSSION

Thoughts?

Comments?

Research ideas?

Intervention ideas?

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Further resources

Tax Administration Research Centre discussion papers

Preparing a series focused on tax behavior psychology – 3 forthcoming discussion papers:

- Social norms - how they influence compliance and how to design effective social norms campaigns
- Fairness – fair taxation, fair administration and effects on compliance
- Attitudes regarding taxation – do they reflect behaviour?

Other discussion papers: please see tarc.exeter.ac.uk

Can provide a [reading list](#) for research presented today

Thank you!

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