Nudging Tax Compliance

The study of the role played by institutions in increasing tax compliance is relatively new. Institution do not only punish evaders, but they play also a role in favoring compliance. The virtues of an approach that focuses on institution that favour compliance, as in this project, rather than punishing noncompliance, are evident: tax auditing, and prosecuting eluders and evaders, are costly activities, and different countries might find both activities difficult to pursue in the presence of loopholes in the tax codes that give rise to ambiguous interpretations. The research question we ask is: *Does reducing social distance between taxpayers and Tax Authorities through institutional changes increase tax compliance?* We plan to answer this question through a series of laboratory experiments.

Institutions and regulations play a key role in “nudging” citizens towards certain behaviours that are deemed as optimal for them (Thaler & Sunstein, 2009), such as tax compliance. Institutions do so by promoting focus and attention towards the "right" attributes of the available choices. In the standard economic approach to taxpayers’ behavior (Allingham & Sandmo, 1972) the decision regarding how much to evade depends on the taxpayer’s risk attitude and on the subjective probability of being audited. The experimental literature on tax evasion (Christian & Alm, 2014; Bosco & Mittone, 1997; Kirchler, 2007) has demonstrated that the set of drivers of tax evasion is richer, and it includes cognitive and moral elements. Furthermore, the consequences of evading are not purely financial, in the form of fines, but are also reputational and psychological (e.g., shame and guilt). It is evident that experimental economics has significantly enriched our understanding o tax evasion. In this project we progress on this research agenda by studying in the lab how the distance between taxpayer and the Tax Authority affects the amount evaded.

The term social distance has been most recently used by Goeree et . (2010). The paper studies a dictator game in which the players decide how much to send to fellow high-school pupils in Californian schools. The authors find that the greatest the social distance between the players, as measured by the number of “intermediaries” between the players, the less the players send. The authors find that the amount given is proportional to the ratio $1/d$, where d is the social distance between giver and receiver. We similarly analyse social distance as a relevant feature of the exchange between the taxpayer and Tax Authority. In our particular setup distance is not measured by the number of intermediaries, but rather as the distance perceived with the Tax Authority and all the others who enjoy the benefits of paying taxes. If the recipients of government spending financed through taxes are perceived as far and anonymous, the players will evade more frequently. What we are describing is essentially a gift exchange process, in which for the gift of the taxpayer to be given, there needs to be an expectation of the sender and his close affiliates to receive something in return.

It is the expectation of a reciprocation, not only strictly to the taxpayer, by the Tax Authority that drives the decision to be tax-code compliant, we hypothesise, consistently with decades of research on reciprocity (Malmendier et al., 2014).