

Right From The Start

Research and Strategies

* **Swedish Tax Agency**

English translation by Interverbum Språktjänst AB, Lesley E. Cawley

INDEX

Foreword	5
Summary	6
1 Introduction	11
2 Research into tax evasion	13
2.1 <i>Causes of taxpayers' behaviour</i>	14
2.2 <i>Conclusions</i>	15
3 On the importance of norms	16
3.1 <i>Social identity determines which norms apply</i>	16
3.2 <i>What does this mean for the tax administration?</i>	18
3.3 <i>Behaviour can be influenced through norms</i>	19
3.4 <i>Do as others do or do the right thing?</i>	20
3.5 <i>Scepticism about the importance of norms</i>	22
3.6 <i>Cooperation is the best strategy</i>	24
3.7 <i>Norms of cooperation are of benefit</i>	27
3.8 <i>The threat of punishment increases the willingness to cooperate</i>	30
3.9 <i>Different reasons for complying with rules</i>	32
3.10 <i>What importance does compliance enforcement have?</i>	35
3.11 <i>Conclusions</i>	37
4 On trust and confidence	38
4.1 <i>Trust and confidence are very important</i>	38
4.2 <i>Benefit-based norms are not enough</i>	39
4.3 <i>What kind of trust is there?</i>	42
4.4 <i>How should Government act?</i>	43
4.5 <i>Taxpayer surveys confirm the importance of trust</i>	48
4.6 <i>An authority's attitude influences trust</i>	49
4.7 <i>Conclusions</i>	51
5 On knowledge	53
5.1 <i>A history lesson gives us understanding</i>	53
5.2 <i>What history can teach us</i>	55
5.3 <i>Systematic risk management</i>	56
5.4 <i>The importance of knowledge cannot be overestimated</i>	56

6	On the tax gap	59
6.1	<i>Size and development of the tax gap.....</i>	59
6.2	<i>Anatomy of the tax gap</i>	60
6.3	<i>Effects of the tax gap.....</i>	63
6.4	<i>Some structural causes of the tax gap</i>	66
6.5	<i>Action strategies</i>	70
6.6	<i>Conclusions.....</i>	71
7	On unintentional non-compliance	73
7.1	<i>What is unintentional non-compliance?</i>	73
7.2	<i>Does unintentional non-compliance create a tax gap?</i>	74
7.3	<i>Causes and effects.....</i>	75
7.4	<i>Twofold gain from reducing unintentional non-compliance</i>	76
7.5	<i>Possible measures.....</i>	76
8	On crime	77
8.1	<i>Why do people commit crime?.....</i>	77
8.2	<i>What does the economic criminal look like?</i>	79
8.3	<i>A strategy for preventing economic crime</i>	80
8.4	<i>Conclusions.....</i>	81
9	On punishment.....	82
9.1	<i>The purpose of punishment</i>	82
9.2	<i>Does punishment work?.....</i>	84
9.3	<i>Conclusions.....</i>	89
10	On audit activity.....	91
10.1	<i>What is the purpose of audit activity?</i>	91
10.2	<i>Service and audit activity.....</i>	91
10.3	<i>The audit activity requirement and large sums of money.....</i>	92
10.4	<i>The importance of audit frequency</i>	93
10.5	<i>The hit-rate is extremely important</i>	95
10.6	<i>Audit activity strategies</i>	96
10.7	<i>Conclusions.....</i>	100
11	Mixed theories, models and strategies	102
11.1	<i>Prospect Theory.....</i>	102
11.2	<i>Other behavioural theories.....</i>	105

11.3	<i>The psychologist's strategem</i>	106
11.4	<i>Braithwaite's compliance model</i>	110
11.5	<i>The compliance pyramid</i>	114
11.6	<i>Preventing error, non-compliance and fraud</i>	116
11.7	<i>The letter-writing authority</i>	118
12	On strategies and strategic thinking	122
12.1	<i>Different views of strategies</i>	122
12.2	<i>Conclusions</i>	125
13	Overall conclusions	126
	References	129

Foreword

Progress is always necessary. Not to progress is to stagnate and to retrogress. It is therefore important for a tax administration to take advantage of the research and knowledge that exists with regard to tax evasion and the behaviour of taxpayers.

This report has been commissioned by the Swedish Tax Agency. The purpose of the report is to describe the available research and knowledge in this sphere, and to make analyses and propose strategies: strategies that can best help to reduce the tax gap.

The research described in the report has been obtained from a number of different sources, both government bodies and academic institutions, and from well-known and less well-known researchers. While use has been made of a great deal of internal material from the Swedish Tax Agency itself, most is from institutions and researchers outside Sweden.

Research and knowledge are necessary, but it is not until conclusions are drawn and ideas are translated into action that effects can be achieved. This report therefore contains an account of research results from a wide variety of areas, as well as conclusions and a number of proposals for appropriate strategies and measures. While these proposals are in no way exhaustive or complete, the report does contain a good deal of knowledge that can form the basis for continued discussion and development.

Although the report has been produced for the use of the Swedish Tax Agency, much of the content should also be of interest to tax administrations in other countries.

Solna, Sweden, 1 August 2005

Lennart Wittberg

It is a good habit now and then to question things that one has taken for granted for years.

German proverb

Summary

Reasons why rules are complied with or broken

There are several reasons for tax avoidance and tax evasion. However, research clearly shows that financial incentive, as well as the risk of detection and punishment, is less important than the influence of norms and moral values.

Human behaviour is governed to a great extent by social norms, which means that people do what other people do and that they avoid doing things that can lead to social disapproval. One of the strongest norms governing human behaviour is reciprocity. This means that people “repay” a certain kind of behaviour. An individual will choose to cooperate and to contribute to the common good if others are doing the same. It is also about conditional cooperation. These norms have developed through evolution and are both socially learnt and biologically inherited.

This has importance for the way in which, in general terms, a system of risk of detection and punishment can influence behaviour. Most people comply with rules, not because they are afraid of being found out and punished for not doing so, but because they regard it as being right and because others are doing it. The deterrent effect of compliance enforcement is therefore slight, but its norm-reinforcing effect is all the greater. Since a prerequisite for compliance is that other people are complying with the rules, people must be able to trust to the fact that other people cannot break the rules and go unpunished, and so compliance enforcement is important. A system of risk of detection and punishment enables people to trust that other people are complying with the rules; then they, too, will comply with the rules themselves.

Trust is crucial

Public trust and confidence in the ability of a government body or authority to ensure that other people comply with rules is therefore absolutely crucial: public confidence in an authority is on the whole extremely important. People who trust the tax administration are less likely to evade or fiddle their tax than people who do not. The trustworthiness and credibility of an authority also has an effect on everything it does. An individual will more readily accept a negative decision if the action of the authority was perceived as fair. The feeling of trust and of being treated justly and fairly is influenced by what attitude the authority has. Citizens who feel they are treated with respect, understanding and helpfulness will have more confidence in the authority. The importance of a high degree of trust and confidence in the tax administration cannot be overestimated.

Increased compliance and increased trust are mutually reinforcing. Resistance or hostility from taxpayers because of bad behaviour on the part of the tax administration leads to reduced compliance and reduced trust, and in this case, too, the reduction is mutually reinforcing.

Knowledge about the tax gap

The knowledge possessed by the Swedish Tax Agency on the subject of tax evasion behaviour and its causes is insufficient. There are historical reasons for this, inasmuch as previous taxation organisations were based largely on personal knowledge of the taxpayers. In the situation we have today, what are needed instead are specialised operations that can collect and compile knowledge.

The knowledge we have of the “tax gap” in Sweden indicates that it has remained unchanged for the last two decades (the “tax gap” represents the shortfall between theoretically correct revenue and the actual revenue collected, attributable to non-compliance with tax laws). There is nothing to indicate that the tax gap will increase. The greater part of the tax gap is made up of illicit work in the informal economy and unreported income, and a very large proportion of it can be attributed to small businesses. Big companies go in for highly advanced tax planning, which also leads to a big tax gap. Medium-sized companies do not go in for advanced tax planning to the same degree, nor do they participate in the informal sector to any great extent.

Illicit work has a negative effect on the economy as a whole; licit work is always better even if illicit work can in some cases be better than no work at all. Economic growth is slowed by tax evasion. When considering the consequences of tax evasion, one cannot simply assess the size of the tax gap but must also take into account the fact that the tax collected by government will be reduced overall as a result of the negative impact on economic growth.

There are structural reasons for tax evasion, one of which may have to do with the visibility of transactions. More tax evasion goes on in cash-based businesses since the transactions are easy to conceal. Another structural cause is what is frequently termed the post-industrial dilemma. Companies in the services sector often develop more poorly in terms of productivity than companies in the industrial sector. It is, for example, easier to increase productivity in the automotive industry than it is in the hairdressing sector. This creates an imbalance since the pressure on wage increases is just as great in both sectors. When productivity cannot increase, tax evasion may be viewed as the only possibility.

There is nothing to indicate that the tax burden has any influence on the degree or extent of tax evasion. On the other hand, the general public’s acceptance of the tax system is important. If there is public acceptance of the tax system (even if there is high taxation) fewer people will evade tax than if there were no acceptance.

Unintentional errors or unintentional non-compliance are estimated to contribute not inconsiderably to the tax gap. There are several positive effects to be achieved by taking action to rectify unintentional errors or non-compliance. Compliance costs are reduced and trust (and thus the willingness to comply) increases. At the same time, limited audit resources can be concentrated on intentional non-compliance.

Crime and punishment

There exists a relatively large body of research into economic crime. This knowledge can also be used in the Swedish Tax Agency’s other activities (that are not involved in working with economic crime). The basis for preventive work is to understand the

causes of economic crime and tax evasion. The strategies chosen must have an effect on the causes and be based on a problem-oriented approach.

Punishment can have both negative and positive effects on behaviour. The outcome depends to a great extent on how the punishment or penalty is imposed. It must be perceived as just, fair and legitimate. Punishment has a very weak deterrent effect, but can help increase compliance if punishment is seen to make other people comply. There is much to indicate that the rules on tax penalties need to be revised.

Audit strategies

The existence of tax audit activities¹ has an absolutely crucial importance for compliance. There is, however, nothing to indicate any connection between the level of audit frequency and the general preventive effect of audit activities. Much more important is what is audited and how it is done. Successful audit activities must be able to contribute both to individual preventive effects and general preventive effects. Different audit strategies may then be required in different situations.

A general strategy should not be based on a specific type of tool, however (such as audit activities). The focus should be on problems and solutions, not on individual tools.

Theories, models and measures

There are many behavioural theories that can provide valuable knowledge of the causes of taxpayers' behaviour. One such is the Prospect Theory. From this theory it is possible to deduce inter alia that checking of the preliminary income tax levied in Sweden should be a successful strategy and that the preventive effect is greater the earlier the tax evasion is detected.

In the work of developing appropriate strategies to curb tax evasion, a variety of models can also be used. One example is the compliance pyramid that is employed in a number of countries. This involves dividing taxpayers into different groups: at the bottom of the pyramid are the honest taxpayers and at the top the dishonest taxpayers (with different degrees in between). Different measures are needed for different groups and the aim is to get most taxpayers to the bottom of the pyramid.

The measures taken by the Swedish Tax Agency consist not only of providing service to taxpayers, audit activities and proposing draft legislation. There are also other types of measures, such as campaigns aimed at influencing taxpayers' attitudes, letters sent to taxpayers with specific information targeted at the individual, cooperation with trade associations, and so on. These are measures which are in use but which could be used even more.

A general strategy

A successful strategy builds on knowledge and an awareness that the world around one will be changed precisely because of the strategy one has chosen. This is not enough, however: a strategy must also be characterised by a holistic approach, flexibility and long-term thinking.

¹ Audit activities are taken to mean a range of compliance activities undertaken by a tax authority including checking, investigation, inspection, desk audits and field audits.

At an overarching level, a general strategy may be described as follows:

- The strategy must always be founded on *knowledge*. Little knowledge can be misleading but sufficient knowledge can provide an insight that enables a number of situations to be understood. Knowledge is needed of the causes of errors, non-compliance and behaviours, and of the effects of different measures.
- The strategy should be aimed at solving identified *problems*. The strategy should not be tied to one tool or specific tools, but the aim must be to solve the problems using the most appropriate tools.
- An important starting point is that *norms and moral values* determine behaviour, and also that audit activity and punishment can maintain norms but only act as a deterrent to a limited extent. The cause of behaviour is what other people do. The Swedish Tax Agency should therefore ensure that *everybody else is doing the right thing and fulfilling their obligations as taxpayers*.
- In order for this to succeed, there must be a high level of *trust and confidence* in the Tax Agency.

A holistic view is important, but it is also important to see the different parts and how they all hang together.

Specific measures

Below are some *examples* of specific proposals that are put forward in the report. The background and reasons for the proposals appear later in the report.

- The effect of brochures and information letters can be intensified by using forms of address that place the recipient in as large a group as possible (see 3.2).
- The Tax Agency should also use alliances with other organisations to a greater extent than today in order to influence norms and attitudes (see 3.2).
- More information should be given to taxpayers about the possibilities the Tax Agency has of using information and records from third parties in its audit activities (see 6.4.1).
- The number of field audits of small companies should increase. On the other hand, the number of more extensive field audits of medium-sized companies should be reduced. The number of educational visits to medium-sized companies should increase, as well as the number of greatly delimited field audits (see 6.5.2).
- The work of preventing unintentional errors and non-compliance should be further intensified (see 7.4, 7.5).
- The rules for tax penalties should be reviewed (see 9.2).
- It should be possible for taxpayers to publicly disassociate themselves from tax evasion on-line (see 11.3.1).
- The Tax Agency should provide more information about adjustment decisions made in favour of taxpayers (see 11.3.3).

- In brochures and similar, it should be stated clearly *why* a certain form has to be used or *why* a certain box has to be filled in (see 11.3.6).
- Sending letters direct to taxpayers is a method that should be used more frequently (see 11.7).

*In this world nothing is certain
but death and taxes.*

Benjamin Franklin

1 Introduction

The problem of tax evasion has existed for as long as taxes have existed. The question is how a tax administration, with limited resources and limited opportunity for surveillance and audit activities, should act to achieve its objectives.

The best thing from a tax administration's point of view would be for everyone's tax to be right or correct from the very start, that is to say compliance that is fully and genuinely voluntary. The measures that a tax administration chooses to implement should in other words have a preventive effect. Preventive measures are key, even if there will always be a need to do something about errors that have already occurred. In the sphere of medicine, different types of methods are described for preventing disease. *Primary prevention* involves measures to prevent the occurrence of a disease; *secondary prevention* involves measures to detect the illness as early as possible and to provide rapid treatment; and *tertiary prevention* involves measures to reduce the harmful effects of established disease. The most successful policy in the long term should be to invest as far as possible in primary prevention.

Which strategies should one then adopt to achieve these aims? Here, research into tax evasion, as well as the Swedish Tax Agency's own experience, can be of use. We need to know more about the tax gap and about the reasons why tax evasion, errors and non-compliance occur. Since this is all about taxpayers' behaviour, we need more knowledge about human behaviour in general and about how people follow rules in particular. Notwithstanding, this is not enough – we also need to know how different measures work. How can audit activities and other measures have a preventive effect?

The aim of this report is to arrive at appropriate strategies using a scientific method of approach. Old truths declaimed such as “everyone knows” that such things go on or “it's always been like this” are perhaps myths or else perhaps the world has changed. Notwithstanding, complete knowledge can never be achieved, and research is not always right, but that is no reason for rejecting it.

To gain the best possible picture of the problem, an interdisciplinary approach has been applied. Research from disciplines such as economics, sociology and psychology has been used, but also disciplines like biology and philosophy have something to contribute. Subjects such as game theory and evolution add valuable knowledge. It becomes particularly interesting when links can be demonstrated between completely different areas. Based on these points of departure, the report considers the reasons for the tax gap (the shortfall between theoretically correct revenue and the actual revenue collected), the underlying causes of people's behaviour, and how audit activities, punishment and other measures work. From this, certain conclusions can be drawn and proposals for measures can be identified.

The report consists of a number of different chapters that can be read independently of the others. The fullest, most comprehensive picture can of course be gained if all the parts are read. The report ends with some overall conclusions. It is easy to observe that research offers a great deal of knowledge that can be of value when developing strategies, ranging from small, simple stratagems and measures to fundamental approaches and ideas.

The research results presented provide the basis for identifying considerably more concrete measures and proposals than are actually mentioned in the report. One possibility, and hope, is that each new proposal for new measures and strategies can be checked off against the knowledge contained in this report, irrespective of the background for the proposal. It should lead to measures that pull in the same direction.

*People can have a ruler, people can have a king,
but the man people have cause to fear is the taxman.*

Sumerian proverb, 2000 B.C.

2 Research into tax evasion

Research into tax compliance or taxpayers' behaviour began largely in 1972 as a result of the research done by Allingham and Sandmo. Allingham and Sandmo presented a model which, in simplified terms, posited that tax evasion was a product of the risk of detection and punishment in the form of tax penalties.

This was a purely economic approach based on economic rationality, defined simply as a "calculus of pleasure and pain" expressed in monetary terms.

In its extreme form, this narrow approach does not take into account any moral or social aspects of tax evasion but regards it as a purely economic decision. There are gains to be made if the evasion is successful and costs in terms of penalties if it fails.

If detection risk and punishment are the only factors that determine whether an individual will cheat on his tax or not, one can ask oneself how high the risk of detection must be in order for it not to be profitable to cheat. Let us assume that the tax penalty or penalty surcharge is 40 % and that the gain from the cheating is 1000. The cost of detection can then be calculated as $1.4 * 1000$ (the tax one would still have had to pay plus the penalty), that is to say 1400. It is not certain that the cheating will be discovered, and so this sum must be multiplied by the probability of detection. We can calculate the gain and the cost as follows:

Gain	1000
Cost	$1400 * \text{Probability of detection}$

It is always profitable to cheat if the gain is greater than the cost: when the gain and the cost are the same, it is no longer profitable. This occurs at a detection probability of 71 %, since $1000/1400 = 0.71$. This means that it is always profitable to cheat if the audit frequency (detection risk) is less than 71 %. Since the actual frequency is lower than this, it means that everyone should cheat. But not everyone cheats.

Taxpayers the world over cheat less than these models predict. Studies have shown that some people never cheat even if the risk of detection is non-existent (James et al 2001). There must, therefore, be other explanations for this behaviour.

With regard to detection risk and punishment, there should theoretically be no difference between whether the detection risk is increased or the punishment is increased: both measures should result in increased compliance. Empirical evidence does, however, suggest that the risk of detection is more important than the punishment (Sour 2001, Tyler 2001, Webley 2002). But the risk of detection is not the most important thing.

Even if there is a connection between detection risk, sanctions and the degree of tax evasion, the research shows that *the fear of experiencing feelings of guilt and the risk of social stigmatisation has a considerably greater deterrent effect*. The research points to the fact that measures aimed at raising taxpayer morale have the greatest effect on the tax gap (Taylor 2001 a).

Feelings of guilt and social stigmatisation are about personal and social norms. Since they are more important than detection risk and punishment for influencing the behaviour of the individual, it is important for a tax administration to know how norms affect behaviour. A successful tax administration cannot rely solely on traditional methods such as audit activities and punishment. Underlying factors that govern human behaviour must be understood and treated in the right way.

Taxpayer morale is important for the prevalence of tax evasion. Research shows that equity, fairness, norms and trust in the tax authorities affect taxpayer morale (Torgler). People who regard themselves as having a higher taxpayer morale also experience a higher risk of detection (Andreoni et al 1998).

Even if there are other factors than economic rationality that are significant, it does not mean that economic self-interest can be completely disregarded as unimportant. Economic self-interest is important, particularly with regard to companies (James et al 2001). Economic self-interest should, however, be regarded as a factor that is balanced by other factors. Other factors are based on broader behavioural issues and build on other disciplines like psychology and sociology (and variants of these, such as fiscal psychology or social psychology).

It is not only important to ask ourselves why taxpayers cheat. The above considerations also show that we must ask ourselves why taxpayers do *not* cheat.

2.1 Causes of taxpayers' behaviour

Below are a number of different reasons why some taxpayers cheat and others do not according to Webley (2002), who has done a good deal of research in this area.

Opportunity

The opportunity for cheating has been described, with the support of several studies, as being the most significant factor in order for cheating to occur. For example, a business-owner has considerably more opportunity than a wage-earner.

The question, however, is what are the cause and effect of this behaviour? Is it the case that people who have the opportunity to cheat do so precisely because the opportunities are greater, or do tax cheaters seek out situations where the opportunities are greater?

To understand this behaviour, studies of opportunity do not appear to be a practicable approach, however. The only thing we know about cheating and opportunity is that those who have the opportunity to cheat do so more than those with little or no opportunity, which should be self-evident. While this is an important piece of knowledge when one is looking for tax evaders, it does not explain the cause of the behaviour.

Equal and fair treatment

The way taxpayers perceive equity and fairness in a tax system has importance for whether the system is accepted or not. There is horizontal injustice, which means that people with similar incomes are treated differently. There is also vertical injustice, which means that taxpayers do not consider they are getting value for the tax they pay.

Individual differences

There is wide support for the idea that egoism predicts the breaking of rules in a number of different areas. Also the attitude to rule-breaking is of great significance. However, it is difficult to decide whether the attitude influences the behaviour or vice versa.

Social norms

If a person believes that tax evasion is widespread, he or she is also more likely to cheat.

Knowledge of taxation and the tax system

Studies suggest that increased knowledge of the tax system has direct significance for the attitude to tax evasion.

Small business owners commonly have a poor knowledge of tax and book-keeping. Tax evasion is often connected to liquidity problems, which in turn are often associated with an inadequate knowledge of finance and accounting.

2.2 Conclusions

Taxpayers' behaviour is influenced by a number of different factors. A successful strategy for measures to combat tax evasion must attend to all the relevant factors and how they affect one another.

While a great deal has been written about different aspects of compliance, there is very little to suggest how these different aspects should be combined to formulate an overarching strategy. An effective method for reducing tax evasion in one area can lead to it increasing in another area through tax evaders changing their activities to achieve the same gains.

Tax evasion can never be fought successfully unless we have knowledge of the causes and of the effects of measures taken to combat it.

In the remainder of this report, we will attempt to provide a deeper understanding of taxpayers' behaviour and the underlying causes. It is particularly important to study the significance of norms and moral values since they influence behaviour more than detection risk and punishment.

*Laws never would be improved,
if there were not numerous persons whose moral sentiments
are better than the existing laws.*

John Stuart Mill

3 On the importance of norms

Social norms can be seen as the values of a certain social group. *Personal norms* are the individual's own ethical values and moral convictions (Wenzel 2002 a).

Social norms can work as a deterrent to tax evasion by way of the tax evader meeting with the disapproval of the people around him. Social norms can also encourage cheating if it is conceived of as something positive. The same is true of personal norms. Tax evasion can lead to feelings of shame and guilt or to feelings of pride and justification, depending on which norms apply.

In order for social norms to have any effect, the individual's environment must know of the act. Personal norms have an effect irrespective of whether anyone else knows of the act, since the individual always knows what he or she has done.

3.1 Social identity determines which norms apply

Through experiencing oneself as a member of a social group, attitudes and behaviours are adapted to the kinds of attitudes and behaviours that benefit the group instead of those that only benefit oneself, since the group is a reflection of the self. This indicates that self-interest need not be in opposition to the common interest.

Social values only have an effect if people identify themselves with the social group, however. Sometimes an individual regards himself or herself in terms of "we" and sometimes as "I", in contrast to "the others" or "you/him/her". When one regards oneself as "we", one has identified oneself with a group. An individual can identify himself or herself with a number of different groups and this can vary over time and from one situation to another (Taylor 2001 a). For example, an individual can sometimes see himself or herself as "we motorists" and sometimes as "we pedestrians" depending on the particular situation. The groups an individual identifies with are called *ingroups*, in contrast to other groups that an individual does not identify with, which are called *outgroups*.

The social norms of a group can thus influence the behaviour of individuals who identify with the group. This adjustment is not a result of group pressure but the result of a process in which the norms are internalised by the individual and become a real part of his or her values (Wenzel 2002 a). Social norms that are adopted by the individual become quite simply the individual's personal norms.

3.1.1 Social identity is influenced by others

Social identity is partly a question of choice, partly a question of learning, but it is also about the influence of other people. We create an identity for ourselves based among other things on what we see of ourselves through others' eyes (Bruce 1999).

How people see themselves is determined to a great extent by how others see them. This can also be self-fulfilling. A young girl who repeatedly fails to tidy her room, be ready on time and do other things she is supposed to do, may repeatedly be depicted as an “airhead” by her father, in a jocular sort of way and without any malicious intent. If the expression is repeated frequently by parents, relatives and friends, the girl may come to internalise this as an image of herself. She sees herself as scatterbrained and incompetent and comes more and more to act the part. An expression intended to describe an existing character can actually help to create precisely what it thought it had observed (Bruce 1999).

Another example might be an accountant who is falsely accused of having committed economic crime. He is jailed, loses his job, and his wife leaves him, taking the children with her. When he is released from prison he cannot get a job, his friends desert him and he is excluded from the golf club. While in prison he got to know people who did not look down on him for his alleged criminality. He gets an offer to work for some criminal individuals, which he sees as his only possibility. Treating people like criminals can make them precisely that (Bruce 1999).

In psychology, this is described as *Labeling Theory*. When society or some other authority punishes someone for a certain behaviour, the individual becomes a deviant and is placed outside society. This leads to a situation in which the individual himself considers himself as standing outside society. The individual begins to behave as society expects him to behave.

Many of these ideas derive from the work of the sociologist Howard Becker, who in 1963 wrote the following:

Deviance is not a quality of the act the person commits, but rather a consequence of the application by others of rules and sanctions to an offender. The deviant is one to whom labels have successfully been applied; deviant behaviour is behaviour that people so label.

3.1.2 Only those who are members of the “right” group can influence behaviour

The social norms in the ingroup have significance for the individual’s behaviour. The norms in the outgroup exercise no influence on the individual. However, a certain influence can at times be found inasmuch as the individual adopts the opposite norms compared with the outgroup. Ingroup members are regarded as more reliable, pleasant and trustworthy, while outgroup members are regarded as unreliable, unpleasant and untrustworthy. See Figure 3.1 below.

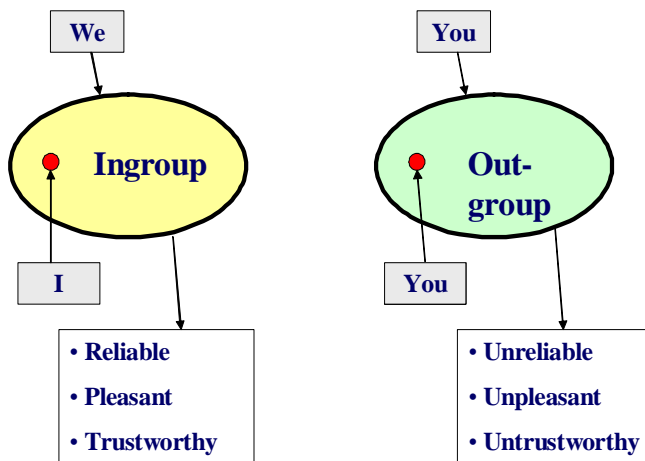


Figure 3.1 Social identity determines which norms apply

3.2 What does this mean for the tax administration?

For a tax administration, it is therefore important to attempt to be included in the ingroup. All measures carried out by a representative of an outgroup will be regarded with great suspicion and scepticism. If similar measures are carried out by a representative of the ingroup they will be regarded more sympathetically. It can be difficult for a tax administration to try to belong to several different groups, and so the trick is to enlarge the ingroup so as to include everyone. It is thus a matter of getting taxpayers to think in terms of “we taxpayers” or “we citizens” and in that way making the group as large as possible and including the tax administration. This can affect the norms which are currently strongest in the individual and the tax administration can be experienced as more trustworthy and reliable. See Figure 3.2.

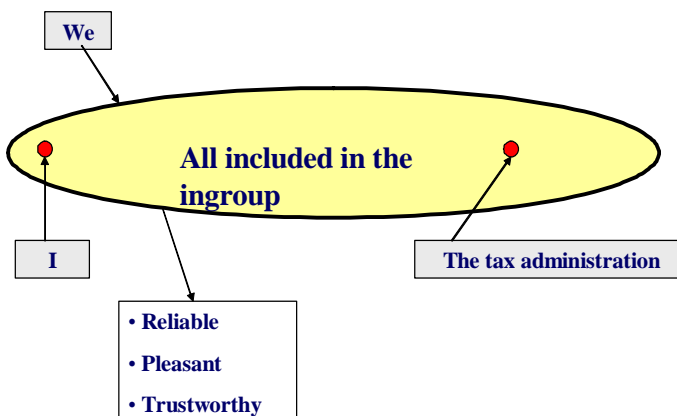


Figure 3.2 An enlarged ingroup

It is possible to influence the psychological situation by placing the recipient in another category in another social context. Compare, for example, the following forms of address in a letter to a taxpayer:

Dear NN emphasising the individual’s own self

Dear Shoemaker emphasising affiliation to the group of shoemakers
Dear Business-owner emphasising affiliation to the group of business-owners
Dear Taxpayer emphasising affiliation to the entire group of taxpayers

This may, but need not, be sufficient to place the recipient in another social context, and thus behaviour can also be influenced by shifting the frames of reference.

The above considerations should be taken into account when producing products intended to reach many taxpayers (for example the “Time to complete your tax return” brochure that is sent to all Swedish taxpayers). In creating these products, an effort should be made to place the recipient in as large an ingroup as possible.

Another method that a tax administration could use is to build alliances with participants who are members of the right ingroups. A taxpayer may perhaps take in a message which, for example, comes from his or her own trade organisation more readily than a message that comes from the tax administration.

3.3 Behaviour can be influenced through norms

That norms are important and that it is possible to influence behaviour through norms, has been demonstrated by studies from Australia and the USA. In Australia, a group of taxpayers were given the results of a questionnaire survey by special letter dispatch. The questionnaire showed that there was a difference between what *most people think* and what they *think other people think*, that is to say a difference between people’s own personal opinions and the opinions they think other people have. Most people believed that one should pay tax, but many people believed that other people did not think so. The result was that voluntary compliance was higher in the group that were told about the results of the questionnaire than among the others. Those who received the results gained the impression that most people believed that one should pay tax (Wenzel 2001 a).

A similar survey was done in Minnesota in the USA. A group of taxpayers were sent a letter with the following content:

According to a recent public opinion survey, many Minnesotans believe other people routinely cheat on their taxes. This is not true, however. Audits by the Internal Revenue Service show that people who file tax returns report correctly and pay voluntarily 93 percent of the income taxes they owe. Most taxpayers file their returns accurately on time. Although some taxpayers owe money because of minor errors, a small number of taxpayers who deliberately cheat owe the bulk of unpaid taxes.

The letter had a positive effect on compliance. Another group of taxpayers were sent another letter that contained rational arguments describing what the taxes would be used for and explaining that society would suffer if people did not pay their taxes. This letter had no effect (Minnesota Department of Revenue 1994).

That there is a difference between norms and norms is also shown by the previous example from Australia. Another group was namely told that the questionnaire showed a difference between what *most people actually do* and what they *think that other*

people do. While most taxpayers are honest, many believe that other people cheat on their taxes. The results showed no difference in compliance.

The Swedish Tax Agency's own questionnaire surveys confirm the picture that most people regard themselves as honest while at the same time believing that other people are less honest (RSV 2003:2).

In these surveys, only 7 % of respondents agreed with the statement "*For my part it's OK that people cheat on their tax if they have the opportunity*". This shows people's personal point of view, and the vast majority quite clearly do not accept tax evasion.

Questions about what people think about other people's tax evasion produce a different picture. Only 22 % of respondents agreed with the statement "*In Sweden everybody or almost everybody pays the tax they should*".

People's own personal opinion is that tax evasion is not acceptable, but they do not believe that other people share that view. To inform people about that fact, that is to say the misunderstanding that exists, can lead directly to an increase in voluntary compliance.

3.4 Do as others do or do the right thing?

The classic American public service TV announcement against littering begins with a shot of a stately American Indian paddling his canoe up a river that carries with it various kinds of litter and pollution. After coming ashore close to a litter-filled roadside, the Indian sees how a bag of litter is flung out of the window of a passing car. The camera shot pans slowly from the litter at the Indian's feet to his face, where a tear is shown running down his cheek. Then a slogan appears: "*People start pollution, people can stop it.*"

According to the organisation "Keep America Beautiful", this is the single most memorable and effective anti-litter message that has ever been communicated to the American public.

Research shows, however, that the film contains characteristics that are not optimal, or which are even negative, for the effect on littering. In addition to the effective message encouraging people to stop littering, the film also shows that people actually litter. Two different norms are ranged against one another, morally and descriptively.

Moral, or prescriptive, norms indicate which behaviours are socially acceptable or socially unacceptable. Descriptive norms indicate which behaviours actually occur. Extensive research indicates that both types of norm influence human behaviour; we tend to do what is both socially accepted and what is popular. The insight that these norms should be placed on a par with one another, instead of against one another, in connection with communication has a direct effect on how messages are apprehended or interpreted (Cialdini 1996).

Descriptive norms

Research is in agreement that descriptive norms influence behaviour. One example is a study that was carried out in 1969 in which a group of people standing staring up at the

sky on a street corner was gradually augmented by passers-by. In the end, 84 % of all passers-by did exactly the same as the group. Descriptive norms work like this: “*If everyone does or thinks it, it must be a reasonable thing to do or think*”.

Moral or prescriptive norms

As opposed to descriptive norms which indicate what is actually done, moral norms indicate what should be done. They indicate the moral rules that apply within the group. Moral norms work by promising social rewards or punishments. When descriptive norms inform about behaviour, they are morally prescriptive.

Convincing experiment about the power of norms

An experiment involving litter (Cialdini 1996) showed the power that norms have to influence behaviour. The aim of the experiment was to see whether people littered more in an already litter-filled environment compared with a clean environment.

The experiment was conducted by tucking flyers underneath the windscreen wipers of cars in a car park. The aim was to see whether the car drivers threw the flyers on the ground or not. The car park was prepared in two different ways: in the first the car park was completely clean, and in the second the car park was badly littered. To further accentuate the norm, in part of the experiment they had a passer-by throw litter so that the drivers saw this just before reaching their cars.

The bar chart below (Figure 3.3) shows how many drivers littered in a clean and in a littered environment respectively. There are two alternatives for the respective environments: a passer-by who litters and a passer-by who does not litter.

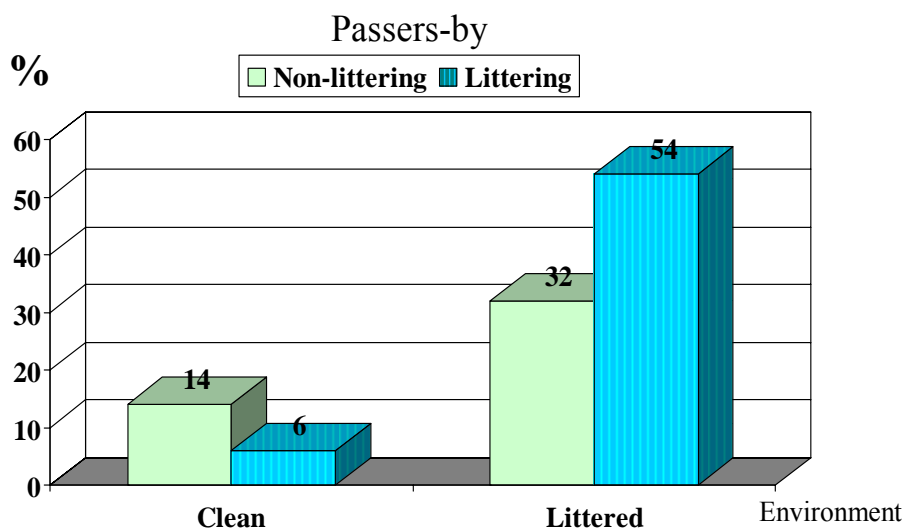


Figure 3.3 Cialdini's experiment with norms

The most littering occurred in a littered environment where a passer-by littered. The least littering occurred in a clean environment where a passer-by littered. Seeing a passer-by littering thus reduced the littering in the clean environment but increased the littering in the already littered environment. The reason is that the passers-by made the car drivers aware of which norm was actually in force. Seeing someone littering in an already littered environment points very clearly to the prevailing norm. Seeing

someone littering in a clean environment creates a contrast which signals clearly that this is deviant behaviour that goes against the norm. Thus, this strengthens the norm that one should not litter.

People who are made aware that littering is a normal occurrence tend to litter more, not less. Therefore, when trying to change an undesirable behaviour, one should be very cautious about dramatising the negative effects of the behaviour by describing it as normal.

For a tax administration it is not a matter, therefore, of portraying tax evasion as normal, ordinary behaviour, for then it will increase. Instead, the fact should be emphasised that most taxpayers are honest and that cheating is the exception rather than the rule. Pointing to the honest majority can help to reduce cheating. The true picture must be given, the extent of cheating must not be kept secret, but the whole picture must be described so that the real proportions emerge.

3.5 Scepticism about the importance of norms

There have been some objections to the idea that norms should have decisive importance for the occurrence or non-occurrence of tax evasion.

Edlund and Åberg (2001) assert, among other things, that there is good reason to question the value of social norms as an explanation of compliance. A social norm must fulfil a function in order for it to be created and to survive. A sufficient number of people must have an interest in the norm being complied with. Most people probably have an interest in other people paying their taxes, but if they do not pay tax themselves they will still have access to government services. This is the classic “free-rider” problem which can be solved partially through informal norms that condemn tax evasion. This is not enough, however. There must be communication about these questions and other people must have the possibility to furnish sanctions or rewards aimed at the individual. Research shows that taxpayers rarely get to know about tax evasion within their own group even if it is detected by the tax administration. Discussions about tax probably do not happen very often and such discussions are probably most common within groups that have major opportunities to avoid tax. In such groups the social norms can work in favour of tax evasion. Social norms do not have such an effect on people that they can counteract the opportunities and incentive for cheating. Economic self-interest takes over.

Why, then, do most people choose to cooperate and contribute to the public good by paying tax if economic self-interest says that it does not benefit the individual?

3.5.1 Why does cooperation occur?

The existence of cooperation and helpfulness in all their forms has been a hard nut to crack for scientists throughout history. When Charles Darwin introduced the theory of natural selection in the second half of the 19th century, generous and altruistic behaviour became even more difficult to explain.

Everywhere among people and animals, Darwin saw cooperation and helpfulness. In the beginning, he was afraid that this apparently inexplicable phenomenon was a threat

to his entire theory of natural selection. How could natural selection favour unselfish, or altruistic, behaviour that is costly for the giver and that benefits others instead?

When Darwin studied colonies of insects, however, he discovered that their workers and soldiers willingly sacrificed themselves for the good of the colony. This made him realise that the theory of natural selection could also include family and close relatives. By benefiting one's relatives, one can benefit oneself. By helping your sister or brother, you are at the same time helping some of your own genes and in that way increasing the evolutionary success of your genes. Darwin's theory was nevertheless still unable to explain why unrelated individuals help one another (DN 2001).

It is not only a matter of biological evolution, however, but also social evolution. Social norms arise through an evolutionary process where individuals rationally imitate the behaviour of others. These norms are then based on a cost-benefit analysis; a balancing between the benefit of complying with a norm and the discomfort of deviating from others' actual or expected behaviour (Lindbäck 1997). If a social norm is of benefit to the species, all its members have an interest in it being developed and maintained. Darwin's theories are true also for the development of social norms.

The question is, then, what weighs heaviest when it comes to tax evasion? Economic self-interest can be important and may perhaps take over even if a person thinks that taxes must exist. Paying tax, which most people do, should then be a manifestation of irrational altruism and go against self-interest. Research is clear about this, however. *The fear of feelings of guilt and the risk of social stigmatisation, i.e. personal and social norms, have a considerably greater effect on the decision to pay tax than pure economic self-interest* (Taylor 2001 a). It is in the individual's interest to avoid feelings of guilt and social stigmatisation. Choosing to cooperate, for example by paying tax, is then not a question of altruism but very much a decision of benefit maximisation.

Research shows that individuals tend to cooperate with others even under circumstances when self-interest should result in them not doing so. People tend to contribute to the public good (for example pay tax) if they perceive other people doing it, even if they would benefit personally from not contributing (Lederman 2003 b).

There are extensive studies which show people's tendency to cooperate and repay in kind. It is a matter of *reciprocity* or mutual cooperation. People contribute and cooperate if they find that they are not being exploited and that others are also contributing. Even a lack of cooperation is repaid by a person no longer cooperating. Reciprocity need not be complete; most participants will accept certain exceptions as long as they are few (Tullberg).

The psychologist Cialdini (2001) believes that *reciprocity is one of the most basic norms governing human behaviour*.

Reciprocity can be recognised from everyday life. If we get a present from someone we feel an obligation to repay it; the same is true of repaying favours or invitations to parties. Researchers have shown that reciprocity is a strong norm in all cultures, and that it has been so for a very long time. A concrete example is from Ethiopia which, in 1985, despite extreme drought and many years of hunger, donated 5000 dollars to

Mexico in connection with an earthquake there. The reason was that Mexico had given money to Ethiopia in 1935 when it had been invaded by Italy (Cialdini 2001).

Cialdini (2001) also recounts an experience of his own, which shows the power of the norms of reciprocity. He was asked on the street by a 12-year-old boy if he would buy tickets to a boy scouts' circus. He declined, but then the boy said: "OK, if you won't buy any tickets at least buy some of our big chocolate bars; they only cost a dollar each". Cialdini bought a couple and then discovered that something strange had happened. The reason was that (a) he didn't like chocolate bars, (b) he likes dollars, (c) he stood there with two chocolate bars, and (d) the scout walked off with two of his dollars. Reciprocity also works in such a way that a concession from someone must be repaid with a concession of one's own. The scout had made a concession by saying that Cialdini didn't need to buy any tickets. Cialdini was then compelled to also make a concession, which in this case was to buy two chocolate bars (see also 11.3.3).

Norms of reciprocity can in other words be very strong, but they must also be beneficial if they are to survive.

3.6 Cooperation is the best strategy

If mutual repayment, or cooperation, is the best strategy, it is not surprising that evolution has created strong norms of reciprocity. That cooperation really is the best strategy is shown by research into game theory.

Game theory is used to study how individuals arrive at the best strategy in a given situation. A classic example from game theory is called the Prisoners' Dilemma.

Two burglars, Al and Bob, have been arrested by the police on suspicion of burglary. Unfortunately for the police, there is only evidence of illegal possession of a weapon. But the prosecutor puts them in separate cells and makes them an offer: mitigation of sentence if each offers evidence against the other; if both refuse they will at least go to jail for illegal possession of a weapon, one year each. If both testify against one another they will both go to jail with a substantial sentence, ten years each. If only one testifies he can go completely free, and the other will get 20 years. Both have the choice between cooperating by staying silent and informing on one another. The question is how Al and Bob respectively should act to achieve the best result?

The best strategy is to cooperate and for both to refuse to testify as the outcome will be one year's jail. But if neither party can trust the other, the result can be 20 years in jail. If Al informs on Bob he can go free, but that will mean that Bob gets 20 years in jail if he refuses (and vice versa). In that case it is better to strike first, that is to say to snitch. If both men snitch they will both get 10 years in jail, which is not the best outcome but is rational from the individual's perspective.

A more general variant of the Prisoners' Dilemma is described below (see Figure 3.4). Person A and Person B can choose between contributing (cooperating) and refraining from contributing (defecting). The outcome for the respective alternatives is shown in the figure by numbers – the higher the number, the better the outcome.

		Person B	
		Contribute	Refrain
Person A	Contribute	3 : 3 Cooperation	-1 : 4 A is a saint/loser
	Refrain	4 : -1 A is a freerider	2 : 2 No cooperation

Figure 3.4 The Prisoners' Dilemma according to Tullberg

With a game theory approach each person should choose the alternative "Refrain" since it gives the best outcome irrespective of what the other person does. If A thinks that B will choose to contribute, the best choice for A is to refrain since it gives 4 instead of 3, while if A thinks that B will instead choose to refrain the best choice for A will still be to refrain since it gives 2 instead of -1. The same reasoning applies for B. The end result is therefore that both refrain and no cooperation occurs (2:2).

This is remarkable since the best outcome for both is to choose to contribute (3:3). That both act rationally does not lead to the best outcome (Tullberg).

3.6.1 The expectation of what others will do is decisive

In reality an actor often acts based on an assessment on how the other actors will act. When people decide to act in one way or another, in the process of making that decision they have often attempted to predict the various conceivable reactions of other people or of the opposite party (Rothstein 2003).

People choose quite simply to reciprocate in advance. In most dilemmas, according to the above model people are willing to cooperate if they think that others will cooperate. A person often chooses to act in the same way as he or she expects others to act (Cialdini 2001).

In one experiment with reference to the Prisoners' Dilemma, the persons taking part in the experiment were questioned about their expectations of the other person's behaviour. Of those who thought that the other would contribute, 83 % decided also to contribute. Of those who thought that the other person would not contribute, only 15 % chose to contribute (Tullberg).

On what basis, then, can one predict the actions of other actors? Rothstein (2003) believes that the decisions people make are to a great extent based on a *collective memory* of previous events. Future acts are in other words assessed based on one's own and others' experience from earlier actions. The description of the history that exists (regardless of whether it is true or false) is of great importance.

This also means that it is very difficult to change a position of non-cooperation to a position of cooperation.

Even if there will always be some free-riders who never cooperate and some saints who always cooperate irrespective of what other people do, most people will do what others do. This means that the great majority will either end up in the "Cooperation" position or the "Non-cooperation" position. In terms of game theory this means that

there are two positions of equilibrium. Even if both positions are stable, it is a problem that the “Non-cooperation” position is more stable (more difficult to change) than the “Cooperation” position.

3.6.2 The best strategy

If people encounter each other only once (play only once), all analyses show that it is smartest to be “cheated” in the Prisoners’ Dilemma. You get only one chance. But what happens if you encounter each other several times (repeat rounds of the game)? Here, one must take into account not only what one can win today, but also what has happened and what may happen in the future. It is important to have a strategy (Sandberg 1999).

In order to identify the best strategy, the researcher Robert Axelrod started a computer tournament in which he asked several researchers to create computer programs that would play different strategies in a game of the Prisoners’ Dilemma type. The programs ranged from simple rules of thumb to smart systems that attempted to work out the opponent’s weak points. Axelrod then let all the programs play against one another and compared their total sum of points.

The winner proved to be “Tit for Tat”: cooperate with the opponent as the first move, then do what the opponent did the previous time (i.e. reciprocate). This was one of the simplest strategies. One might say that this strategy is “kind”; it does not “cheat” unless provoked.

Axelrod also experimented with a tournament that attempted to simulate evolution. He started with a population of computer programs that used different strategies, and, depending on how many points they scored against one another, their number increased or decreased. What happened was that in the beginning “nasty” strategies grabbed points wildly from easily cheated strategies that always cooperated. The “nasty” strategies gained many points and took over the population. But when they actually played against one another, the “nasty” strategies gained few points since they were trying to cheat all the time. This gave other strategies the chance and “Tit for Tat” they took it; the players who followed it cooperated internally and did not allow themselves to be cheated by the others. In the end there was virtually only “Tit for Tat” left.

Furthermore, in other experiments it was shown that even a small group of “Tit for Tat” strategies could invade and take over a large population of “nasty” strategies that were doing their utmost to exploit all the others. This is the greatest advantage of a “Tit for Tat” strategy: a single, kind individual will not survive, but a small group can cooperate internally and, slowly but surely, grow. Naturally, this will not work if they allow themselves to be exploited by others; one must be kind but not naive (Sandberg 1999).

3.6.3 Other experiments based on game theory

That reciprocity is of fundamental importance for understanding human behaviour is also supported by other experiments based on game theory (Lederman 2003 b).

One experiment is called the *Ultimatum Game*. The game has two players and involves them sharing a given sum of money between them. The first player, the bidder, makes

an offer for what the other player, the respondent, can have. The respondent can choose to accept the offer and then gets the sum offered (and the bidder gets the rest of the total sum) or he can reject the offer, which means that neither player gets anything. Economic theory says that the respondent should accept any offer at all that is greater than zero. Frequently, however, the respondent rejects offers that are less than 20 % of the total sum.

Other types of experiment which produce similar results are, for example, the *Investment Game*. The first player gets a given sum of money and has the option of keeping it or transferring some of the money, which is adjusted upwards by a certain factor, to a second player. The second player can either keep all of it or give back some of the money to the first player. The second player has no reason to give back money but should keep all of it, but most frequently some of the gain is transferred back to the first player. This is something that the first player expects and therefore gives money to the second player instead of keeping everything.

Another example is the *Dictator Game*. This game is reminiscent of the Ultimatum Game but with the difference that the respondent cannot choose but the bidder decides how to distribute a given sum of money. Consequently, the bidder has no incentive to give away money but should keep all of it. And yet what happens is that a third of bidders (dictators) give away between 8 % and 16 % of the total sum.

3.7 Norms of cooperation are of benefit

Norms have a rational basis, otherwise they would not exist, and an apparently altruistic behaviour like cooperation is essentially a rational behaviour that benefits self-interest. Pure altruism and pure egoism have not proven to work: altruists get exploited and egoists are unfair to everyone and thus themselves.

Even if altruism is sometimes held up as an ideal, there are no strong norms that support such behaviour, quite simply because altruism does not work. The strongest norms are about cooperation, that is to say reciprocity.

Objections against reciprocity working are sometimes raised by quoting the example of “The stiff door problem”. A stiff door on the underground railway is difficult to open, but once it is open considerably less effort is required to keep it open for more people to go through. Here there is the possibility of gain if the person who is first through the door makes a marginal sacrifice and holds it open for the people following after. The question is how reciprocity can work in an anonymous big city with low probability of encountering the same people again?

This reflects a misconception about the concept of reciprocity. Reciprocity is not connected with the party with whom one has cooperated: reciprocity is general in the sense that individuals cooperate if other individuals cooperate, irrespective of with whom they cooperate. If you hold open the door for others, I will hold open the door for others. This is the way the norm has developed because it is the method that works best.

Another situation involves whether one should save a dying person in the desert even if it is extremely unlikely that that person would be able to repay the favour.

Reciprocity works through the possibility that someone else might be one's own saviour at some time.

The norm works by means of the act creating a sense of positive self-esteem in the rescuer. It can even give social standing and prestige. An individual who does not save a person in need can instead experience negative feelings in the form of loss of self-esteem and shame. These feelings do not exist by chance but they govern behaviour. They lead to better decisions for the survival of the species, which is what evolution is all about.

So reciprocity works, repayment is not linked to a particular situation, nor does repayment need to be on the same level. The point of reciprocity is that the individual behaves as others behave towards him or her. An experiment from 1972 illustrates this very clearly (Tännsjö 2000).

The experiment goes as follows. A telephone box is rigged up in a public square. Some people who ring from the phone box get their change back, others don't. When they come out of the box they are met by Alice, who right at their feet drops a book manuscript, which blows away in all directions. Will they help Alice to pick up the manuscript? What will the typically feeling-oriented female political activist do? How will the hard-boiled male stockbroker react?

The result is clear. If the stockbroker has got back his change, he helps Alice with the manuscript. If he hasn't received his change, he doesn't help. The same goes for the female political activist. If she's got her change back, she helps, otherwise not. It is not only general character that has proven to be irrelevant for behaviour. Gender is also of no significance in this situation. Everything stands and falls with the change money!

3.7.1 Has the evolution of norms influenced the evolution of the brain?

If social norms have developed through evolution, the brain may perhaps also have developed to be able to handle social norms. Evolution favours biological and social skills that are beneficial for the survival of the species.

Antonio Damasio, the prominent professor of neurology, has described the link between emotion and rationality (2003). His thesis is that emotions cannot be separated from rationality; they are intimately connected with one another. Emotions are needed in order to make good decisions. Emotion cannot be viewed as some luxury accessory. Evolution would not have created emotions if they were not beneficial for survival.

Even if social training is perhaps sufficient for learning social norms, there is probably a link with innate biological regulating mechanisms. Damasio believes that there is a link between basic innate drives and the most elevated ethical rules and conventions, quite simply because it contributes to the survival of the species.

The human brain is equipped from birth with drives and instincts that not only include a set of physiological control mechanisms, but also the basic tools that the individual needs to adapt to a social context. During childhood and adolescence these are influenced and developed by external cultural conditions. The combination of innate instinct and acquired survival strategies creates something that is presumably unique to

humans: a moral sense which in certain contexts can enable the individual to disregard the immediate interests of his or her own group.

If the brain is adapted to supporting a certain behaviour, this should be expressed in different ways. In order for a strategy that emphasises reciprocity to function, the actors must be able to detect those who cheat (those who choose not to cooperate). This was something that the researchers Cosmides and Tooby took as their starting point for an experiment. Their hypothesis was that the brain contains functions for detecting cheating in situations that build on mutual cooperation. They formulated one and the same logical problem in two different ways: one as a problem of social cooperation and the other as a problem without any link to social cooperation.

The participants in the experiment were given some clues about people in different situations and were asked to state which people were violating the rules. In one case the rule was “*If a person goes to Boston, then he/she takes the subway*”, which is a non-socially related problem. In the other case the rule was “*If you are to eat those cookies you must first fix your bed*”, which is a socially related problem. In both cases the rule is “*If A then B*”. Cheating involves exploiting the benefit without doing what is required (B without A or eating cookies without fixing the bed).

Only 25 % succeeded on the basis of the clues in solving the problem with the rule “*If a person goes to Boston, then he/she takes the subway*”, while 80 % succeeded in solving the problem with the rule “*If you are to eat cookies you must first fix your bed*”.

The explanation is that the brain is designed in such a way that there are ready-made functions or routines for detecting cheating in social situations (or “hard-coded software”). These routines function only in special situations and cannot be used to solve general problems of logic. In these cases other general routines for logical thought are required, which explains why they are more difficult to carry out.

Damasio (2003) calls these biological processes dispositive representations in the brain. They involve innate neural circuits that have been developed through evolution for solving specific problems. The human brain contains a number of different neural circuits of this kind, ranging from those that are about basic biological regulation to “elevated” functions such as thoughtfulness, love, sympathy, honesty and other laudable qualities.

Does this mean that true altruism does not exist and that emotions and moral values are only biological processes in the brain? Damasio (2003) has the following to say about this:

The knowledge that there are also innate biological mechanisms behind the most splendid human behaviour in no way means that this should be reduced to mere neurobiology. To attempt to explain something apparently complex by pointing to the less complex phenomena that are a part of it, does not imply any lessening. --- Our convictions, emotions and intentions are dependent on a number of factors rooted in our organism as well as in the culture in which we have grown up, even if we ourselves are not conscious of these factors.

3.7.2 Moral norms are more than benefit

Not all researchers share the view that moral norms are something beneficial that have developed through evolution. The objections to this theory generally involve describing benefit-based moral norms as indicating a poor view of human beings or that humans are far, far more than this.

On the subject of benefit-based moral values, Tullberg has the following to say:

Ethics can either be developed and made part of this scientific project, where they are expected to contribute with something as simple as benefit. Or else they maintain the distance to trivial reality and assist with thoughts of a more ideal world. Visions that one has hoped to influence in the “right” direction, but whose effects have frequently been practically destructive. Is it not questionable to judge ethics so much according to ambition and so little according to result?

Ethics should perhaps not be viewed as a choice between being good or evil, but as a question of what is an appropriate method. In a situation that is difficult to analyse, imitation is a simple method with several benefits. --- Ethics should perhaps not be seen as an alternative to selfish interest, conformist adaptation and adaptive sensitiveness, but more a policy for acting with rather than against these components.

The objective that a moral action is reward enough in itself will probably always be only an ambition. When social norms are no longer rational, they will be undermined (Tullberg).

3.8 The threat of punishment increases the willingness to cooperate

We like to punish people who violate written and unwritten rules. This willingness to punish has a basic importance for maintaining norms.

In order to test the importance of punishment, the researchers Fehr and Gächter (1999)² conducted an experiment in the form of a game, in which each person in a group gets a given sum of money. They are all then given the opportunity to invest an optional portion of the money in a shared pot. The money in the pot will be doubled and then distributed in equal shares to the entire group. It is completely immaterial how much each and every member of the group invests, everyone gets the same return. The best outcome for the group is achieved if everyone invests the maximum amount possible. This gives the biggest total return. However, for each individual it is most profitable not to invest at all and at the same time to hope that everyone else will invest the maximum amount.

There is consequently an opposition between cooperating for the common good and being a parasite on others in order to maximise self-interest. (This can be compared to contributing to common benefits by paying tax. It is also the same type of problem as described in the Prisoners' Dilemma.)

² More about this research can be found in RSV Report 2002:14.

During the first rounds of the game it was not permitted to punish any stingy co-players who kept their money. The result was that the investments decreased drastically and cooperation died out after a few rounds.

But when the participants got the chance to punish those who sponged on their fellow players, the trend reversed quickly, despite the fact that it cost money to punish someone. By the last round, the average investment had risen considerably and the researchers drew the conclusion that punishment, or the threat of punishment, could maintain cooperation in the groups. The results appear in Figure 3.5.

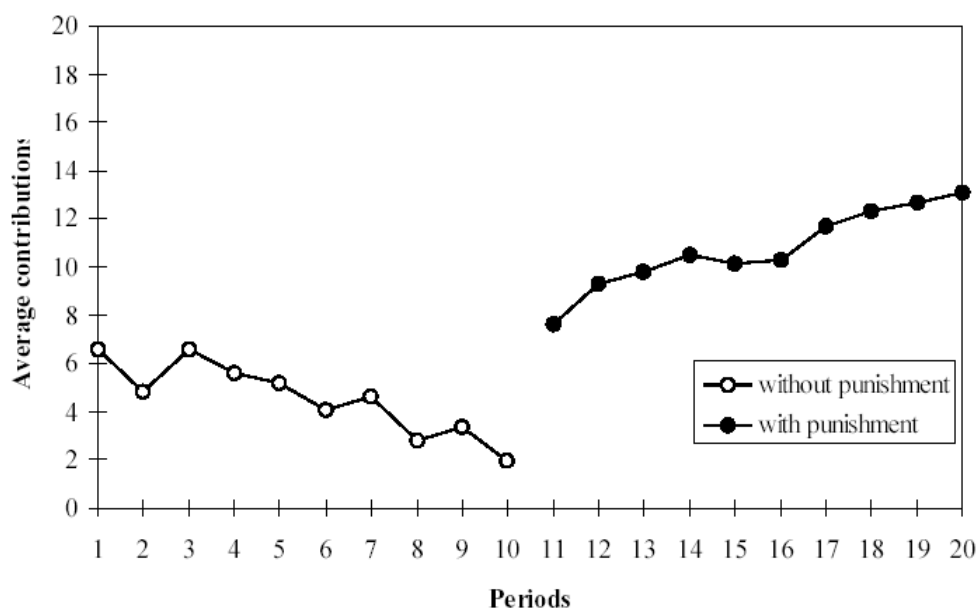


Figure 3.5 Fehr and Gächter (1999)

What surprised the researchers was the enthusiasm with which the participants punished those who sponged on their fellow players, despite it costing the participants money and despite the fact that they would not encounter the same spongers again.

In order to better understand what lay behind the great desire to punish, the researchers questioned the participants about their emotions during the course of the game, both when some teammate had been manifestly egoistic and, on the contrary, when they themselves had been caught sponging through a round of the game by someone else. The answer was that it was downright anger that lay behind the desire to punish. It was also feelings of shame that prompted the spongers to start raising the stakes.

People are quite simply willing to punish those who violate basic principles of justice or fairness. People are moreover more inclined to cooperate if they perceive the situation as fair.

3.8.1 Even monkeys react to unfairness

When capuchin monkeys at the primates research centre in Atlanta were treated unfairly, there was uproar in the cages. The monkeys refused to cooperate with the human researchers leading the experiment – they were no longer willing to hand over

small rocks in exchange for food. They took the pieces of cucumber – which they normally regarded as a perfectly reasonable exchange for a small rock – and hurled them on the floor instead of eating them. This protest was triggered when monkeys saw another monkey in an adjacent cage receive a better reward – a grape – for the same work. The reaction was most extreme when the neighbour monkey received a grape without doing any work.

It may seem a stupid and irrational reaction to refuse to eat one's piece of cucumber and to fling it on the floor. But in the long run it can be good to look after one's interests.

The conclusion drawn from this experiment is that it is not only people but even some monkeys that have feelings of fairness. This indicates that a dislike of unfairness and injustice has an early evolutionary origin (DN 2003).

This supports the idea that (moral) norms are something that have developed through a process of evolution and that they are to a high degree based on rational grounds, otherwise they would not have survived evolution.

3.9 Different reasons for complying with rules

Norms and punishment are consequently both important for whether a person chooses to cooperate or not. There are different reasons why people choose to comply with rules.

A person can choose to comply with rules because social norms have been internalised in that person and become a part of his or her convictions. Rules are then complied with quite voluntarily because they are regarded as being right (that is to say there is a moral conviction). Rules can also be followed in order to avoid trouble in the form of informal or formal punishment (external incentive). These reasons can be combined to form four different alternatives according to Figure 3.6 below (Tullberg).

	External incentive	No external incentive
Intrinsic motivation	Self-interest	Moral conviction
No intr. motivation	Pressure	Docility

Figure 3.6 Different reasons to comply according to Tullberg

Intrinsic motivation means that there is an internalised moral norm which says that one must comply with the rules. This motivation can then be combined with situations when punishment is used or when punishment is not used.

In the docility group there is no external incentive or intrinsic motivation to comply but it happens anyway. Here, there is a great risk that compliance will not occur.

Which of the other forces is, then, strongest in establishing compliance? The intrinsic motivation has an advantage. A person who is ruled by his conscious is always controlled; an external pressure can never have the same permanent presence.

To act on the basis of the threat of punishment is to act in accordance with self-interest. An external incentive can produce the desired behaviour but that does not mean that behaviour is morally right. Instead of being a moral decision it may then be a benefit maximisation decision. The outcome will be that compliance will be reduced in each instance when the external incentives are too weak.

However, if a specific norm is only followed for moral reasons but not out of any self-interest in the form of external incentive, this shows that the norm is half-hearted or incomplete. In these situations, rules are only followed because they are “right”, not because they are “good” in the sense that there is a rational value in following them. But if there is a rational value in following the moral norm, there is also self-interest. Self-interest in the sense of both “right” and “good” is thus better than moral conviction alone.

Even if an external incentive can be a factor that creates a rational value by following the rules, far too strong an external pressure can, however, displace the reason for compliance from self-interest to pressure, which is much worse than complying for moral reasons alone. In these situations rules are followed only in order to avoid punishment and not because it is “right” to do so; compliance is then not voluntary (Tullberg).

Voluntary compliance without punishment is thus better than compliance enforced with the aid of punishment. It is quite simply the case that voluntary cooperation grows in the absence of a regulatory power and decreases in its presence (Felkins 1999).

In itself this is nothing new; the thought had already occurred to the ancient Chinese. Confucius (500 B.C.) expressed it as follows:

If the people are governed by laws and punishment is used to maintain order, they will try to avoid the punishment but have no sense of shame. If they are governed by virtue and rules of propriety [ritual] are used to maintain order, they will have a sense of shame and will become good as well. --- They can of course be deterred with hard punishment, but even if people try to avoid the punishment they lose in terms of self-respect and moral dignity.

The best combination is consequently a regulatory power that is in line with one’s own moral convictions; then there is the greatest possibility of compliance with the rules.

Sour (2001) supports this when she proposes that the moral valuation of a crime has significance for how much of a deterrent legal sanctions can be. Sanctions against immoral crime can be more effective since they are reinforced by the individual’s own moral view.

This idea is supported by a questionnaire survey³, which showed that 30 % of respondents thought that tax evasion was justified if the tax laws were manifestly unfair. A quarter of respondents also thought that tax evasion was justified if the government was wasting money. However, between 85 % and 90 % thought that tax

³ RAMP is a major European survey.

evasion could not be justified by tax increases or because “plenty of other people are doing it” (Kurtén).

3.9.1 Voluntary compliance is better than the threat of punishment

Compliance with rules solely on the basis of the threat of punishment does not work, then, since it counteracts voluntary compliance.

The psychological explanation for this is generally called *Motivation Crowding Theory* and can be explained briefly as follows (Frey & Jegen 2000):

All forms of external incentive, both positive in the form of rewards and negative in the form of punishment, influence the intrinsic motivation to do what the incentive dictates. External incentive can either *increase* or *decrease* the intrinsic motivation.

External incentive can increase the benefit experienced by doing something or increase the cost of not doing it; the intrinsic motivation can then be reinforced.

The opposite can also occur, that is to say the intrinsic motivation can decrease when external incentive is applied: the external incentive quite simply takes the place of the intrinsic motivation. This can happen because the individual feels himself overmotivated. The same thing happens if no attention is paid to the individual’s own motivation by those exerting the incentive. An individual who does something out of intrinsic motivation loses the opportunity to show his or her active interest or engagement if he or she is ordered to do something or rewarded for doing it. A consequence of this is that the intrinsic motivation decreases.

Whether the intrinsic motivation decreases or increases depends on the following factors:

1. The intrinsic motivation *decreases* if the incentive is perceived as *controlling*. Self-esteem and engagement are reduced as a result.
2. The intrinsic motivation *increases* if the incentive is perceived as *supportive*. If the individual feels supported and with freedom to act, self-esteem and engagement increase.

This theory has been tested in laboratory experiments using a “contract game”. In this game, one player has the option of offering the other player a contract. The other player can comply with the contract or breach it.

If compliance with the contract can be fully monitored and supervised, the contract will be offered and complied with. Trust between the players is replaced by trust in the person doing the monitoring. If the monitoring is removed or greatly decreased, the supervision is replaced by an intrinsic motivation to do the right thing and act fairly. An offer of a contract is then perceived as a signal that the player trusts his opponent. This is rewarded by the opponent also complying with the contract, despite the fact that there is no punishment.

It appears as though an intermediate level of supervision is most detrimental. It is not enough to maintain compliance but it is sufficiently powerful to counteract the intrinsic

motivation. In these instances, no contract is offered quite simply because the probability of it being complied with is judged as far too low.

Sociologists have shown that people take greater responsibility for their actions if they feel that they themselves have chosen an alternative action in the absence of external pressure (Cialdini 2001).

One experiment that involved preventing seven-year-old boys from playing with a toy shows how this functions. A boy was shown into a room where there were five different toys. One of the toys was an expensive battery-driven robot and the others were of a more simple kind. The boy was told the following: “*It is wrong to play with the robot. If you play with the robot, I will be very angry and I will do something about it*”. It was in other words an exhortation combined with a threat. 22 boys were told the same thing. 21 did not play with the robot. Six weeks later, the same boys were shown into the same room in a different context. This time there was a different person conducting the experiment and no connection with the previous event was mentioned. The boys were told that they were free to play with all the toys. 77 % of the boys played with the robot.

In the next phase of the experiment, the same procedure was repeated with other boys. The difference was that the threat was removed. In the first step the boys were told: “*It is wrong to play with the robot*”. 21 of 22 boys did not play with the robot. Six weeks later in the same room, only 33 % of these boys played with the robot.

In the first case it was the threat that caused the boys not to play with the robot, in other words it was external pressure. When the person who delivered the threat could not monitor the behaviour, the boys breached the prohibition. In the second case, there was no threat, but the boys didn't play with the robot because they didn't want to. In this case it was about internal pressure (Cialdini 2001).

The difference between obeying for the moment and obeying for the future thus lies in whether one feels coerced or motivated. In order for a threat to work, there must also be risk of detection. Intrinsic motivation always works. In one's own consciousness, from which one cannot escape, the knowledge is there, and this has consequences for one's self-esteem.

The English author Samuel Butler realised this when he wrote over 300 years ago:

*He who agrees against his will
Is of the same opinion still*

How, then, can an external incentive in the form of detection risk and punishment, that is to say supervision, be used to increase the willingness to comply with rules instead of decreasing it?

3.10 What importance does compliance enforcement have?

Norms influence behaviour more than detection risk and punishment. Norms are about reciprocity. Most people are prepared to follow norms as long as there is an expectation that other people will do so. We have previously also shown that most

taxpayers regard themselves as honest, but that they don't regard other taxpayers as being equally honest. If an individual does not consider that others are honest, his expectation should be that the others will not comply. As a consequence of this, the individual will himself choose not to comply.

In this context, enforcement activities (or audit activities) have an absolutely decisive importance. The reason why an individual complies is not the threat of detection and punishment but that the individual expects that the threat of detection and punishment will get *other* individuals to comply. Their expected behaviour should thus be that they comply. Then the individual will comply, too. Reciprocity therefore works.

The greatest importance of risk of detection and punishment, is thus its norm-reinforcing function by virtue of it being perceived as deterring *other people* from cheating. It is norms that directly govern behaviour, but it is enforcement activities (audit activities) that maintain norms (to cooperate).

This applies in general, but there are of course individuals who are immune to norms and where the direct deterrent power of enforcement activities has an effect. Even in other individuals where norms have the greatest importance, the deterrent effect is part of the picture. There are always a number of interacting factors that govern behaviour. The point is, however, that the deterrent effect is not the most important, nor should it be. A strong deterrent effect decreases voluntary compliance. This does not mean that audit activity should decrease in scope; it means that it should be used in the right way. Audit activity that creates a detection risk with the aim of supporting honest taxpayers increases the willingness to comply. Without audit activity, the tax system cannot function.

If there are no norms to say that people should cooperate, compliance enforcement can in itself force behaviour if it is sufficiently powerful. But as long as norms are not changed, behaviour will change as soon as enforcement activities decrease in scope. Voluntary compliance can only work if the supervision is in line with norms. Risk of detection and punishment can maintain existing norms quite simply, but only with great difficulty can they change existing norms. In the long run, something can only be done about tax evasion by changing the norms.

One example of this is the tax administration in Sicily in Italy (Lappalainen 1993, Lederman 2003 b) which, up until 1984, was in private hands. The private company responsible for tax administration had connections with the Mafia, who in turn had a good knowledge of the income of various individuals and companies. The Mafia could also get tough with taxpayers by resorting to murder to improve compliance. And it worked, too: compliance was very high. After 1984, however, the Italian State took over the tax administration. The State tax administration did not have the same knowledge, nor the same opportunities, to force compliance. Public confidence in the capability of the Italian tax administration to combat tax evasion is very low. The result was that tax evasion increased dramatically

This shows that an external incentive can shove moral norms aside if the rules or the way in which they are exercised are regarded as unjust or unfair. If there are no moral norms, the system will collapse when the external incentive is removed. A system of

rules thus functions if the rules are perceived as morally right and if the compliance enforcement system is perceived to be fair and supportive.

3.11 Conclusions

Behaviour is governed to a great extent by norms. Norms build on what is morally right and on people's actual behaviour. Moral norms have developed through a process of evolution. One of the strongest norms governing human behaviour is about reciprocity: people do what they expect other people to do.

It is also clear that there are strong norms involving justice, equity and fairness. People have a tendency to react strongly to injustices that affect themselves, even small injustices. On the other hand, people are patient and prepared to endure difficult circumstances if they affect everyone in the same situation.

Enforcement activities are of absolutely decisive importance for maintaining and strengthening norms. Voluntary compliance can work if there is audit activity and sanctions taken against those who try to cheat. *This norm-reinforcing effect is much more important than audit activity's deterrent effect.* A change in behaviour can essentially only take place through changed norms.

In reality there are taxpayers who choose both to cooperate and not to cooperate inasmuch as they cheat to a certain extent. This can be an expression of the fact that most people still accept the system but that cheating occurs on the margins in order to improve on one's income. Korsell (2002) takes the view that there are even norms that govern how much a person can cheat. Depending on which group is involved, there may be different norms. A certain amount of cheating is perhaps expected, but it may not be too great (then the system is threatened). There are then norms that regulate the cheating and ensure that it remains at a "moderate" level. Norms that work in favour of cheating should have developed on the basis of the same principles as norms that work against cheating.

Norm-based appeals alone cannot increase compliance, however, since there will always be some taxpayers who are completely immune to even the most powerful norms.

*All genuine helpfulness starts with humility before those we wish to help,
so we must understand that helping is not a wish to dominate but a wish to serve.
If we cannot do this, neither can we help anyone.*

Søren Kierkegaard

4 On trust and confidence

Halloween 1997 was chosen as a fitting day to unveil the “*IRS Horror Story Web Site*”. The site contained numerous testimonies of taxpayers telling how the IRS (Internal Revenue Service) in the USA had abused its power. One newspaper wrote: “*The Congress is unmasking the IRS for what it really is: a bureaucratic monster stalking the American taxpayer*”. At the time, Congress was holding a number of televised hearings at which taxpayers recounted how badly they had been treated by the IRS (Lederman 2003 a).

Congress subsequently passed an Internal Revenue Restructuring and Reform Act, which entailed big changes for the IRS, the objective being to make it more efficient and customer-oriented. Better protections for taxpayers were also introduced.

There were several reasons for these developments, one important reason being that taxpayers had complained about difficulties in contacting the IRS and that the staff were insolent, and also that many field audits were an insult to taxpayers’ integrity. Taxpayers and Congress had had enough after a while, and forced a number of changes.

This example shows what can happen when the public lose confidence in an authority. An authority should never forget who it is there to serve.

4.1 Trust and confidence are very important

The traditional methods of increasing taxpayer compliance are based very largely on detection risk and punishment. This is not always effective, however. Many studies show that measures aimed at deterring people from a particular behaviour sometimes have no effect and that, if there is any effect at all, it is a weak one (Tyler 2001).

Consistent with our earlier line of argument, a successful strategy should go further than relying solely on methods of deterrence: it should also reinforce social norms and willingness to comply with laws and rules.

There are several studies which show that public trust and confidence in Government has a direct effect on the willingness to comply with rules. There is also a clear link between acceptance of tax evasion and a dislike of tax authorities (Webley 2002). Public confidence also has an indirect effect on how authorities are perceived in general as well as the regulatory system as a whole.

One example of a direct effect can be found in the Swedish Tax Agency’s own annual taxpayer surveys (RSV 2002:14). The survey showed how different groups experience

the preventive effect of audit activity, expressed as a combination of the probability of detection and how serious the consequences will be.

The group that experienced the lowest preventive effect was the group with the lowest level of trust and confidence in the Swedish Tax Agency. Those with the highest confidence experienced a greater preventive effect.

An example of the importance of the indirect effect can be found in an evaluation of the campaign against illicit work that the Tax Agency began in 2002. The evaluation was undertaken by Mååg and Sunehag (2003) at the University of Linköping. Their conclusion, supported by the research literature, was that the Tax Agency's positive campaign outcome was a result of the trust the Swedish people have in one another and in Government. This means that the campaign would probably have been a failure if the general public had had no confidence in the Tax Agency.

From Australia there is an example of the tax authorities trying an approach using differently worded texts in a reminder letter (sent to taxpayers to remind them to file their income tax returns and pay their taxes). Letters emphasising respect ("*we believe in your honesty*") worked best with taxpayers (Wenzel 2001 b).

When the water authorities in San Francisco introduced water rationing, the most important factor governing compliance among the public proved to be the credibility of the water authority (Murphy 2003).

In Australia a study was done of how well nursing homes and blocks of service flats for the elderly complied with directions for improvements when inspections were carried out. The results of the study showed that the greatest improvement (highest compliance with the rules) two years after the inspection was in those nursing homes where the inspectors had treated the nursing home managers with respect (Murphy 2003).

4.2 Benefit-based norms are not enough

In the previous chapter we saw that norms govern behaviour to a high degree and that norms generally benefit everyone. Cooperation builds on reciprocity: in other words if you cooperate, I will, too. However, even if everyone profits from cooperation, it may not necessarily happen. How can we get cooperation to work? In practice it is not enough simply to introduce punishment.

Research has indicated situations in which reciprocity was not the best strategy. Conditional cooperation does not work if there is a risk of misunderstanding, and attempts at cooperation can fail. Two actors who use "tit for tat" methods and try to cooperate may fall out; one mistakenly lets the other down, the other gets his own back, the first repays the injury and so on. "Rational" reciprocity can end up in an endless vendetta (Sandberg 1999). Examples from everyday life have shown that such outcomes are not that unusual; many conflicts and wars continue because neither side wants to take the first step towards peace because neither trusts the other (Molander 1997). Conditional cooperation is thus sensitive to disruption; if there is sand in the machinery things can easily go wrong. This sand may be a lack of trust or confidence.

4.2.1 Lack of trust makes the social trap snap shut

Taxi drivers in Palermo in Sicily are like most taxi drivers, but with one important exception: they don't use their two-way radios nor do they use a control centre, despite the fact that there are obvious advantages in doing so. With a control centre, customers need only keep track of one telephone number and they can be picked up by the car that is nearest and can thus save time. Taxi owners get more customers and a shorter way to drive to the pick-up. Customers and taxi owners alike gain by such a system, which is why most taxi owners in different parts of the world have banded together and formed taxi control centres. Everyone wins by cooperating in employing a control centre even if the taxi owners compete with one another.

When a control centre was introduced in the Sicilian city of Palermo, it failed to work, however, and the entire venture ended in chaos. The reason was reported to be that individual taxi drivers, in order to get most fares, gave false information about where they were, saying they were much nearer to the customer than they actually were. Soon all the drivers were aware that there was cheating going on, which led to even more cheating. Since the drivers were unable to trust one another, a snowball effect was created from cheating and even more cheating, until everyone was lying and saying that they were "right in the neighbourhood" in order to get the fare in question. This caused the system to break down, since most chose to defect from cooperation and the control centre was closed down. Instead, the taxi drivers had to queue up at the city's taxi ranks with the consequence that they got considerably fewer fares and longer between each customer. The *social trap* had snapped shut around them; distrust had led them into a situation where they were all losers, despite the fact that they could all see that they would all have gained by trusting one another (Rothstein 2003).

4.2.2 The trap can be avoided if there is social capital

Social traps, which are also frequently known as social dilemmas, are about situations where the collective interests of the group may collide with the interests of the individual. In the above example from Palermo, most of the taxi drivers were surely aware that everyone would win by cooperating. But if people are unable to trust that other people will cooperate, it is of course pointless to choose to cooperate oneself. If everyone thinks in the same way, the social trap snaps shut, and everyone loses out as a result. What is needed to avoid these often destructive situations is *trust*. Rothstein (2003) chooses to call this *social capital*, which can be explained as trust between people. Experimental studies have also confirmed that conditional cooperation works better and is less sensitive to disruption if the actors act more generously and can forgive occasional mistakes (Molander 1997).

Everyone gains by having government services financed by taxes. But no-one wants to be the only one paying tax. Therefore, most people will accept paying tax *as long as everybody or almost everybody pays their taxes*⁴. If other people are not paying their taxes there is no reason to do so oneself; it only results in a big expense, without the government services functioning. In a situation like this, it is most rational not to pay tax despite realising that everyone will lose by it.

⁴ 74% of individuals and 84% of companies are prepared to pay their taxes as long as everybody or almost everybody pays their taxes (RSV Report 2003:2 and RSV Report 2002:12)

If the individual actors trust one another, cooperation can work. This can function well in small groups or communities where it is clear to all who is cooperating and who isn't. The group can also choose to punish those who do not cooperate (the "free-riders") in different ways, for example by means of social disapproval. Such a system is maintained through self-regulation.

Norms like this may be clearly visible in poor and vulnerable societies. When most African peoples lived in small villages, catastrophes could occur at any time because of prolonged drought or violent storms. The people created a defence against this unpredictability by building up a well-developed social safety net where everyone was dependent on everyone else to survive. If a family was hit by a crisis they could always get help from another family, and the same circumstances applied between entire towns and communities, with family ties and ties of friendship with other remote communities. A proverb in Xhosa says: "*People are people through other people*". This kind of attitude created a society where the freedom of the individual was subordinate to the group, but where generosity and hospitality were necessary elements.

In large societies or groups it is more difficult to get cooperation to work since free-riders can hide behind a veil of anonymity. Punishment may be more difficult to impose in these circumstances, while at the same time social disapproval has less effect if it is expressed by people not known to the individual. Problems can also arise in small groups if the actors lack trust in one another.

Moral conviction and norms are perhaps not enough. To resolve this dilemma, an administrative system with rules is often created and a government authority of some kind is charged with monitoring that the rules are complied with.

4.2.3 Dilemma of complying with rules

If an administrative system is created with rules for dealing with the social trap or social dilemma, it also gives rise to another problem, however: the rules must be complied with in order to be effective. This creates a dilemma concerning rule compliance. If formal or informal sanctions are introduced for violations of the rules, the structure of the original social dilemma is changed: it is no longer about cooperating (to achieve a common objective) but about complying with rules (Wenzel 2002 b).

This is an argument similar to that put forward by the 17th century philosopher Thomas Hobbes (in "Leviathan") when he said that self-interest leads to "the war of every man against every man", which is not desirable for anyone and is therefore irrational. He believes that what is needed is an agreement or covenant between all people in a society to follow certain rules that lead to peace but which at the same time means that the people are compelled to give up some of their freedom. He also says in his "third law of nature" that it is not enough with a moral agreement; there must also be compliance with the agreement. For this purpose he introduces the figure of the "sovereign" with unlimited power. Hobbes' main line of argument is that it is always necessary and advantageous to keep agreements, but that man's inherent egoism must be curbed (for his own good) by a system of power.

History has clearly shown, however, that the use of totalitarian power does not work. Another method that has been used is religion, although in today's society this has diminished in importance. The concept of an all-seeing God who knows everything and exacts punishment in the next life can otherwise be an effective method of maintaining the functioning of the system. A variant of this was the practice in medieval times of selling indulgences, which gave remission for one's sins for a certain period. For this, the recipient had to pay a certain sum of money or perform some service (for example go to war). Obviously, one can have moral objections to such practice, but from the purely technical perspective of tax collection it should be efficient.

When self-regulation, dictatorship and religion have been dismissed, there remains a form of regulation that builds on a *legitimate system of power that enjoys the citizens' trust*. This system of power can maintain compliance if the rules are based on moral grounds or developed norms. It must be morally right to cooperate. Cooperation will then arise if there is also compliance enforcement and sanctions that impact on those who try to sponge on the rest of society.

Cooperation does not work, however, if citizens feel they cannot trust the institutions that exercise the power, for example if the institutions are corrupt. Corruption is also an example of a situation in which the social trap has snapped shut. Most people do not approve of corruption and realise that it is a problem, but it is downright pointless to be the only official who doesn't take bribes if you think you know that almost everybody else is doing it (Rothstein 2003).

If the citizens are unable to trust that "everybody else" is cooperating, they will not cooperate themselves, either. The reason why an individual cooperates is thus not in the first instance because of the direct threat of detection and punishment that comes from the system of power, but because the individual expects that the threat of detection and punishment will get *other individuals* to comply.

This applies in general and there are, of course, individuals with whom the direct deterrent power of compliance enforcement can be effective. There are also a number of people who always comply, irrespective of whether there is any risk of detection and punishment or not. Frequently quoted are the words of Chester Bowles, head of the price regulation authority in the USA during the Second World War: "*Twenty percent of the regulated community will automatically comply with any regulation just because it is the law, five percent will seek to evade the regulation, and the remaining seventy-five percent will comply as long as they believe that the evading five percent will be caught and punished.*" (Lederman 2003 b).

4.3 What kind of trust is there?

Swedish government institutions enjoy a relatively high degree of public trust and confidence and corruption is low. According to the "Transparency International Corruption Perception Index 2003"⁵, which grades countries according to how much corruption there is, Sweden lands in sixth place of least-corrupt nations behind Finland, Iceland, Denmark, New Zealand and Singapore.

⁵ For more information, see <http://www.transparency.org>

In general, trust between people is high in Sweden. Surveys show that, in 1981, 57 % of respondents agreed with the statement: “Most people can be trusted”. The equivalent figure for 1997 was 67 % (Rothstein 2003, p. 148). Sweden and the other Scandinavian countries belong to a group that may be termed “high trust countries”.

Public trust and confidence in the Swedish Tax Agency is as follows, according to the three latest polls; see Figure 4.1 (RSV Report 2003:1).

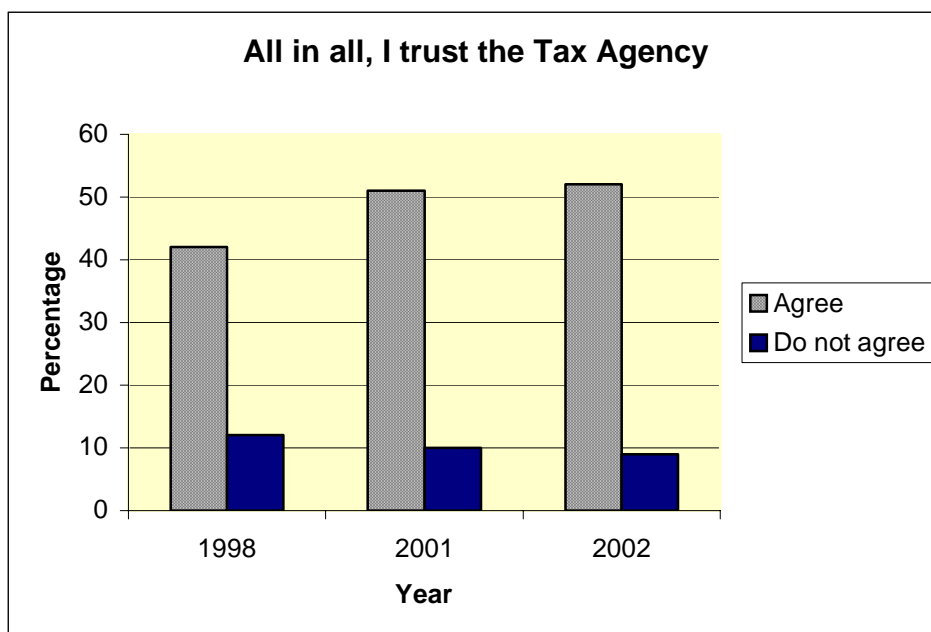


Figure 4.1 Public confidence in the Swedish Tax Agency (RSV Report 2003:1)

The percentage of respondents who trust the Tax Agency has increased slightly, while the percentage of those who do not trust the Tax Agency has decreased slightly. Other responses are neutral or don't know. In comparison it may be noted that the percentage who trust in Government in general is 38 % (RSV Report 2003:2).

4.4 How should Government act?

4.4.1 Impartial and honest institutions

According to Rothstein (2003), the factor that is most significant for social capital (trust) is the existence of universal government institutions. This means institutions that are impartial, fair and which treat everyone equally. What people rely on in these institutions is thus not that they will act in one's direct personal interest in such a way that one receives special favours in relation to other citizens.

Studies suggest that it is the quality of government institutions that means most for economic growth (Rothstein 2004). This means that citizens must be able to rely on Government in order for there to be effective economic activity. Let us assume that Company A wants to sell to Company B (which wants to buy). Company A is, however, unwilling to deliver the goods until it gets paid, since it doesn't trust Company B. Company B is unwilling to pay until it has received the goods, since it

doesn't trust Company A. If the situation cannot be resolved, the trade will be rendered difficult. If there is a functioning legal system (for example a government enforcement service) the companies know that they can take legal steps to get paid or to get their goods. If the legal system is corrupt there will not be this trust in the system, which obstructs the workings of the economy.

There are also studies showing the connection between a general trust between people⁶ and income growth per capita (Andersson 2001).

One experiment indicates very clearly the importance of trust in authorities. Some researchers placed wallets on the streets of a number of cities, ten wallets in each city. The wallets contained money and the name of the owner but no address. The purpose of the experiment was to measure how many of the wallets were handed in to the police in the respective cities. In Oslo, all 10 wallets were handed in to the police (in Stockholm 8), while in Ankara no wallets at all were delivered to the police. The big difference between Scandinavia and Turkey is owing to the fact that the Turkish police are believed to be corrupt. There is no reason to hand in the wallet to the police if the police themselves will take the money. If the police can be trusted not to take the money, one may safely hand over the wallet to them (Rothstein 2004). It is, therefore, public trust in authorities that is the decisive difference and nothing else.

4.4.2 How, then, can trust be created?

Of importance for public trust and confidence is the honesty and irreproachability of the tax administration, or, in other words, its integrity.

Valerie Braithwaite (2003) summarises this well when she says (p. 272):

The argument developed is that integrity and compliance are most likely to be optimised when a tax authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasions, combined with an effective mix of incentives and sanctions. Integrity and compliance are most at risk of parting ways when a tax authority seeks to improve compliance solely through making changes to the administrative or legal infrastructure without regard to the sensibilities of citizens.

Many theoreticians claim that the best way to achieve compliance with rules is not to rely solely on legal coercion but instead to apply strategies that bring out the best in those whom you wish to see complying with the rules.

If an authority treats citizens with respect, the citizens will repay that respect and comply with rules that are fair. Just as the tax administration is looking for real compliance from taxpayers, taxpayers are looking for real integrity from the tax administration.

Trust is a resource that is not like other resources. It does not decrease with use, but decreases with lack of use.

⁶ Measured by questionnaires in which people were asked: "In general, do you think that people can be trusted, or do you think that one cannot be careful enough when dealing with other people?"

However, it would be naive to think that a strategy based solely on trust can work: there will always be certain people willing to exploit the fact that they are treated as trustworthy and reliable. A strategy that combines an expression of trust with the option of coercion if necessary should work best. Having the threat of coercion in the background means that authorities' attempts to achieve an attitude of cooperation should have greater success.

Theodore Roosevelt described this very well in his principle for conducting foreign policy: "*Talking softly and carrying a big stick*". Simply by existing, authority can help to ensure that it never actually needs to be used.

4.4.3 Experience of an authority's actions is decisive

Personal experience in connection with an encounter with an authority can help create the general picture an individual gets of authorities. A person's willingness to accept a decision from an authority is influenced by both how that particular encounter was perceived and by the person's view of authorities in general.

Tyler (2001) has developed a model that describes this experience (see Figure 4.2).

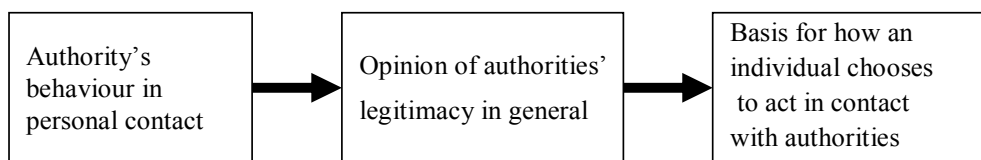


Figure 4.2 Tyler's model of the connection between authorities' legitimacy and personal experience

The key to creating trust lies in the authority concerned acting in such a way that the general public perceives it as *just and fair*. The perception of fairness depends to a great extent on how the citizens perceive the authority's actions, that is to say its *procedures*. If the procedures are perceived as just and fair, the authority will be perceived as just and fair, and then its decisions, that is to say the outcome, will also be perceived as more just and fair (Murphy 2003). An individual may thus perceive an authority as just and fair even if it has made a decision that goes against the individual, if the authority acts fairly when dealing with the case. This leads in turn to fewer complaints about the authority's decisions.

What is important is not, therefore, whether the outcome is positive or negative, but whether it is fair. People are more interested in fairness with regard to outcome and procedures than they are in personal gain. The outcome must be fair for the system as a whole (Wenzel 2002 b). If an authority receives an individual courteously, it shows respect for the individual and helps increase the perception of fairness (Murphy 2003).

Studies show that the perception of procedural fairness is linked both to the acceptance of a specific decision and to the inclination to comply with laws and rules more generally.

Even if the threat of punishment exists in the background (and should be there), most people accept authorities' decisions, not because they are afraid of them, but because they perceive the decisions to be legitimate (Tyler 2001).

Nevertheless, there will always be some people who are not receptive to appeals to norms, and for these the threat of punishment must exist.

The conclusion is that, in a largely law-abiding society, most people will comply with the law because they consider it the right way to act. Just and fair treatment on the part of authorities increases respect for the law and increases compliance. This effect is greater than that of the threat of punishment.

4.4.4 Empirical evidence points to a suitable strategy

Tyler (2001) has done a study of how the general public perceive the actions of power-wielding authorities by interviewing people in California who have been in contact with the police and the courts.

The interview survey showed a clear link between trust in the motivations of legal authorities and acceptance of their decisions. Tyler is clearly surprised at how little significance it has for trust whether the decision is positive or negative for the citizens concerned.

This leads to the conclusion that it is important for authorities to treat people fairly, with respect, to listen to them and to explain their decisions. By doing this, authorities can help create a cooperative attitude among people.

The initial behaviour of the authority is thus decisive for the kind of behaviour that the authority is met with in return.

The police are, for natural reasons, interested in protecting themselves when they encounter potential criminals: from this, it follows that they prefer to meet individuals from a position of superior power. However, this superiority tends to encourage opposition, obstinacy and defiance. Hostility is provoked that leads to increased risk of confrontation. A strategy based on superiority in terms of power can thus lead to increased risk also for those who have the power.

Nevertheless, this does not mean that power should not be exercised by the police or any other authority. Studies also show that unilateral and unconditional disarming will be exploited.

The solution lies in *commencing* with a strategy based on non-coercion, without forcible means or threat. The forcible means must always be to hand, however. A strategy of this nature reacts to threats from others but never commences itself with dictatorial language.

As distinct from those authorities which start out with an approach based on encouraging cooperation, authorities which commence with a confrontational attitude find themselves in a battle of wills resulting in a contest, the outcome of which is increased opposition and defiance, even among those who initially had no intention of opposing.

It is interesting to note that authorities that choose to act from a position of power are able to justify this by referring to a state of affairs that they themselves have created. Dictatorial language and threat create a hostile and menacing situation which in turn creates in the authority concerned the perception that most people are uncooperative and intractable. This leads to the authorities having to employ forcible means. On the other hand, those authorities that adopt a more cooperative attitude themselves will view most people as cooperative (Tyler 2001).

In this way, an authority that sends out signals that it does not trust the citizens provokes distrust in itself. The opposite also applies. Experimental evidence suggests that the ability to trust can be explained as a chemical process in the brain. When individuals can see that another individual trusts them, the levels of the hormone oxytocin increase in the brain. The more oxytocin in the brain, the more the individual trusts other individuals (Zak 2003).

Where the police are concerned, their objective is not only to arrest people in order to reduce crime: their aim is also to build trust and confidence among the general public. Success is achieved by increasing citizen compliance without escalating conflict in a situation when the police are exercising their powers.

A relatively recent study showed that Germany's tax system was very strict and rigid, which led to an efficient but costly confrontation-based system. This decreased taxpayers' willingness to cooperate. In contrast, it was asserted that the British tax system treated taxpayers with greater sensitivity in order to avoid friction (James et al 2001).

Every encounter between an authority and a citizen provides an opportunity for the authority to increase trust and confidence among the general public. The New York Police, for example, operate under the motto: "Courtesy, Professionalism, Respect".

4.4.5 The behaviour of authorities influences the effect of punishment

A survey was carried out among a group of taxpayers in Australia who, after having invested in a tax planning scheme developed by several tax consultants, had had their tax assessments amended by the Australian Taxation Office (ATO) and had also had penalties levied on them (Murphy 2003). The majority of the taxpayers had appealed against the ATO's decision. The survey showed that the group of taxpayers involved had less trust and confidence in the ATO than the population in general. For 89 per cent of the taxpayers, the way in which the ATO handled the matter influenced their view of ATO negatively.

The decrease in trust was linked to the way in which the cases were dealt with, that is to say the ATO's procedures, and not to the decisions being negative.

In an attempt to reduce the number of appeals and angry reactions against the ATO, the penalties were greatly reduced. This had no effect, however. The ATO then tried another course of action which involved acknowledging that the taxpayers had been victims of aggressive mass-marketing and bad advice, and expressing a belief in the taxpayers' honesty. With this approach, 87 per cent of the taxpayers accepted the ATO's decision.

When the taxpayers in the survey were treated as though they had tried deliberately to avoid tax, it shows that the ATO considered them to be unreliable and dishonest. The taxpayers repaid this by harbouring the same feelings towards the ATO.

The survey shows that the use of legal coercion can be counterproductive. The threat of punishment did not increase compliance but provoked the opposite behaviour instead and increased opposition to the ATO.

Authorities must be perceived as representing the interests of those they are set to serve in order for them to be effective. If authorities are not perceived as representative they will lose in respect and legitimacy, which leads to greater opposition on the part of citizens (Taylor 2001 b).

A questionnaire survey in Australia showed that the more power the tax authorities were considered to have, the less legitimate they were viewed as being. This link became weaker, however, the greater sense of solidarity the respondent felt with society (Wenzel 2001 a).

4.5 Taxpayer surveys confirm the importance of trust

To find out whether the above reasoning is applicable to the Swedish Tax Agency, we may analyse the Tax Agency's questionnaire surveys conducted among the general public. Analysis shows that the most important factor determining whether citizens trust the Tax Agency or not is whether it appears to be doing its job properly.

The following diagram (Figure 4.3) shows the proportion of respondents who think that the Tax Agency is doing a good job according to the three most recent surveys (RSV Report 2003:1).

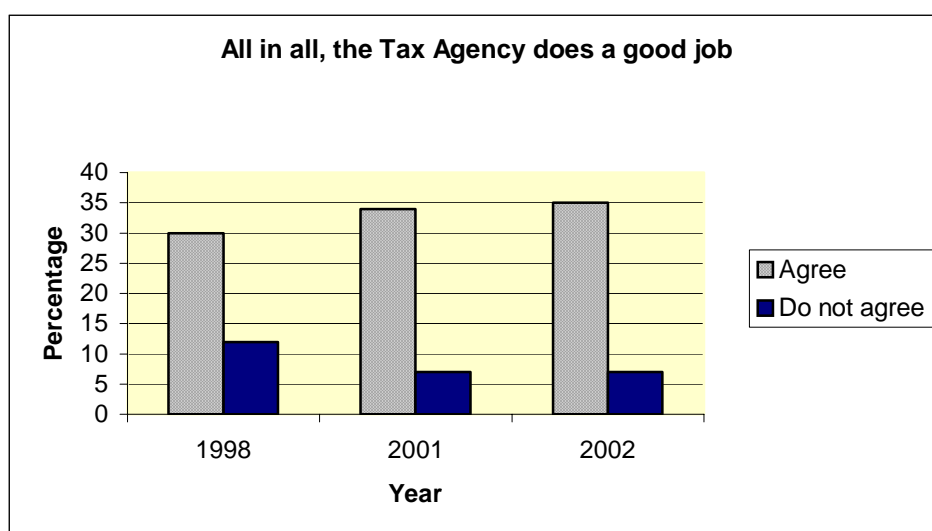


Figure 4.3 Public opinion regarding the Swedish Tax Agency's working methods (RSV Report 2003:1)

The percentage who agreed that the Tax Agency was doing a good job has increased, while the percentage who do not agree has decreased. Other respondents were neutral or had no opinion.

Analysis of the survey shows that what is most important for people when judging whether the Tax Agency has been doing a good job is whether it makes correct decisions. In 2003, 22 per cent of respondents agreed that the Tax Agency made correct decisions. 10 per cent did not agree with the statement and the remainder, 68 per cent, were neutral or didn't know.

In connection with the taxpayer survey in 1998, the Tax Agency carried out a more in-depth study of the link between different responses in the questionnaire (RSV Report 2000:2).

Just as in 2003, it was correct decisions that meant most for determining whether the Tax Agency was doing a good job. Satisfaction with the service was also important. Taken together, satisfaction with the service and satisfaction with correct decisions/fraud detection explains why 68 per cent of respondents agreed that "The Tax Agency is doing a good job".

The above figures confirm that trust is influenced very much by *how* an authority does its job, that is to say whether there is fairness in its procedures and outcome.

4.6 An authority's attitude influences trust

In 2003/2004, NFO Infratest was commissioned by the Swedish Tax Agency to survey the attitudes citizens and companies experienced from the Tax Agency's officials today (STA Report 2004:5). The firm also surveyed the attitudes people wished to encounter from officials and the attitudes that created trust in the Tax Agency. Very briefly, the results were as follows:

The citizens and companies surveyed encountered three different attitudes from the officials. NFO Infratest called these A, B and C.

Attitude A was characterised by behaviour from the official that was perceived as arrogant, accusatory and insensitive. This attitude communicates the view that the individual cannot be trusted (i.e. will cheat).

Attitude B is characterised by the official's behaviour being formal and rule-bound. The official is governed entirely by rules and regulations and appears strict and impersonal. This attitude communicates the view that the individual is only a case to be treated fairly and correctly but also that the citizen should know the law.

Attitude C is characterised by the official being open, and taking time to listen and explain. The individual perceives the official as sensitive, educating and cooperative. This attitude communicates the view that most individuals are honest but that they perhaps don't understand the rules and therefore need some help.

All the attitudes are characterised by the officials behaving correctly and complying with laws and rules. The difference lies in *how* the officials communicate which rules that apply, not *that* the rules apply.

20 % of private individuals and companies agreed that they were received by an official with attitude A, 50 % with attitude B, and 60 % with attitude C. The fact that people were received with a particular attitude does not preclude them also being received with any of the other attitudes (which explains that the total sum exceeds 100 %).

Attitude A has a strong negative effect on confidence in the Tax Agency, attitude B has a slightly less negative effect on confidence, and attitude C has a strongly positive effect on confidence. The negative effect on confidence that is triggered by being received poorly is greater than the positive effect on confidence that is triggered from being received well. It is therefore very important to avoid giving people a bad reception.

The authority's attitude should therefore be "*We aren't a boring authority full of rule-bound bureaucrats, but a vital and exciting organisation that is here to help precisely you*" (Mååg & Sunehag 2003).

4.6.1 How can attitudes be changed?

How is an authority to succeed in practice in treating citizens with respect, understanding and fairness? A method in current use is to employ different types of documents which describe and set out citizens' rights. One example is Australia's Taxpayers Charter from 1997, which states:

Taxpayers are to be treated fairly and reasonably, to have their privacy respected, to be treated as honest in their tax affairs unless the taxpayer acts otherwise, to have decisions explained to them, to be offered assistance, advice, and information in a professional way, and to be helped to minimize their costs in complying with tax law.

Even if a document setting out taxpayers' rights serves a purpose, one might say that the ways things are done in practice is, in actual fact, governed more by institutionalised formal and informal rules than by a document with a lot of high-sounding phrases that has been introduced late in the organisation's history in order to lend it greater legitimacy among the general public. The solution is, therefore, to introduce an approach where values and attitudes are expressed in the concrete activities that occur on a day-to-day basis (Braithwaite 2003).

It is very important to explain *why* a certain behaviour is successful. The vast majority of authorities and officials want to be successful, and for the Tax Agency one of its most important tasks is to increase voluntary compliance. A prerequisite for success is that there is public trust and confidence in the authority and its officials. This is something that must be communicated internally within the authority itself.

A model that explains the effects of persuasive messages is called ELM (Elaboration Likelihood Model). The basic hypothesis of ELM is that the effect of the message depends on how the recipient processes it. The effects are different when messages are

subjected to thorough processing compared with when they are processed superficially. The probability that a message will be the subject of thoughts and reflections depends, according to the model, on the recipient's motivation and ability to process the content of the message (Wennergren 2003).

It is therefore important that there is motivation to process the message. One way of achieving this is to identify the link between the authority's attitude and its results.

4.7 Conclusions

Trust in the Swedish Tax Agency is relatively high, which shows that there is considerable social capital. The best strategy to ensure rule compliance and cooperation is to manage this capital wisely. Since the capital is pretty considerable, no measures should be taken that risk eroding it. A certain but modest return is in other words preferable to an uncertain but potentially greater return.

The distinct conclusion is that trust, or social capital, is the most important asset that an authority can have. Without trust, the effect of all the various measures will be considerably less.

The point of departure must always be that citizens want to do the right thing. If taxpayers will not do the right thing, then more powerful methods should undoubtedly be used. However, there should be a gradual escalation of measures and it is important *how* the measures are carried out.

Taxpayers' attitudes and behaviour are logical based among other things on their experience and perception of the tax system. If the tax system and the tax administration are perceived as unfair or unjust, voluntary compliance will not be enhanced. This makes the tax administration's work more difficult. It is therefore in the tax administration's interest to identify those areas which primarily influence taxpayers' perceptions and to focus on those over which one has some control.

The important thing is not only to take specific measures to enhance public confidence in the Tax Agency; it is also essential to keep in mind the importance of trust in everything the Tax Agency does. For each and every action and activity the question must be asked: How does this affect confidence in the Tax Agency? One example may be the question of informing on people. Should the Tax Agency encourage the public to report tax evaders? On the basis of the account given here of the research done in this area, the answer must be No. Trust between people, that is to say social capital, is not increased or enhanced in an informant society. A different matter altogether is that it is important that the Tax Agency should deal seriously with information given spontaneously.

The importance of trust can be summarised in the, perhaps somewhat drastic, words of Confucius. When asked what were the requisites of good government, Confucius replied:

“Sufficiency of food, sufficiency of military equipment, and the confidence of the people in their ruler.”

“If it cannot be helped, and one of these must be dispensed with, which of the three should be foregone first?”

“The military equipment.”

“If it cannot be helped, and one of the remaining two must be dispensed with, which of them should be foregone?”

“Part with the food. From of old, death has been the lot of all men; but if the people have no faith in their rulers, there is no standing for the state.”

*Know the enemy and know yourself, and in a hundred battles you will never be defeated.
If you know only yourself, not the enemy, your chances of winning and losing are equal.
If you are ignorant of either the enemy or yourself,
you will surely be defeated in every battle.*

Sun Tzu, 500 B.C.

5 On knowledge

Taxes have existed for a very long time, and so some form of enforcement activities in general have also existed in principle for just as long. It may, therefore, seem strange if today we puzzle over the problem of taxpayers' behaviour as though it were a completely new phenomenon.

We don't know enough about how common different taxpayer errors are and the reasons for these. We don't know enough about how best to deal with different types of error. We don't know enough about the underlying explanations for taxpayers' behaviour. Although knowledge is increasing all the time, in relation to long-term experience it is still fairly modest. The reason for this can be explained in part by looking at the history of the Swedish tax administration and its audit activity. The information below is taken from Malmers' (2003) article "Granskningen av inkomstdeklarationer under 100 år" (Review of a century of Swedish income tax returns).

5.1 A history lesson gives us understanding

A decision of the Riksdag (Swedish parliament) in 1678 created some order

In Swedish towns and cities, a Government authority (magistrate) was charged, together with a number of citizens, "*found to be the most capable and reliable*", with imposing as large a proportion of tax on the inhabitants which each "*according to his means and ability could bear*". In practice this meant that taxpayers were obliged to make an oral declaration of their income to the people in charge of the town's finances.

In 1719 a system of special tax assessors was established

The assessor was elected by the townspeople and was charged with assessing, according to his conscience, how much each and every taxpayer should pay. The assessment was based partly on oral information provided by the taxpayer and partly on personal knowledge of the taxpayers.

In 1861 tax committees were introduced

The obligation for citizens to provide information to permit assessment of their own tax that had hitherto been in force was abolished. In each community a tax committee was established, charged with recommending an appropriate assessment for each taxpayer. The recommendation was based on information obtained and knowledge of the taxpayer. Recommendations were made by special assessment committees that were set up in every city, town and parish.

In 1902 income tax returns were introduced

In 1902, responsibility for direct taxation on income was transferred to the State and the obligation for taxpayers to submit income tax returns was introduced. This changed the work done by the tax committees and in 1907 these were abolished and assessment boards were introduced instead. Each municipality formed a tax district. A certain amount of audit activity was to be carried out by the assessment boards, but purely as a spare time activity. The tax work was concentrated on technical auditing, chiefly according to stipulated standards or discretionary auditing.

In 1928 it was proposed that audits be conducted by professional civil servants

Already in 1928 it was proposed to do away with the assessment boards and to employ civil servants to be responsible for the audit activity. The proposal was not implemented, however, since it was felt that the personal knowledge of taxpayers that the assessment boards possessed was of great importance. And so only a very few people were actually employed to work on audit activity. To start with, there were only the county treasurers employed by the county administrative boards, although outside tax experts could be engaged if deemed necessary. Although the number of people employed to work on tax assessment increased slightly over time, in 1942, for example, there were still only 11 full-time equivalents in the county of Stockholm working on tax assessment.

In 1942 a new proposal was made to employ civil servants

In 1942, a tax assessment department was established under each county administrative board. Separate assessment boards for certain groups of taxpayers were created (including for limited companies). All self-employed persons were, however, still to be assessed by their local assessment board. In order to promote uniform tax assessment it was proposed that a central government body be established, Rikskattenämnden (Swedish National Tax Board), which was set up in 1951.

In 1955 a new Taxation Act was passed

Separate assessment boards for the self-employed were established, to be supported by a staff of full-time assessment officers who would concentrate on audit activity. Auditors were also employed. Much of the practical work remained the same, however. A great deal of time was spent in checking statements of income against filed tax returns.

In 1975 the “RS Reform” was launched

The proposal that the actual assessment work should be carried out by full-time civil servants was again put forward in 1973, and in 1975 the Riksdag passed the “RS Reform” (“Rationalisation of the Tax Administration”). This was followed by extensive recruitment of civil servants during the 1970s. Computerisation was introduced and the tax authority’s powers were increased. The ambition was to increase the number of tax field audits from 10 000 to 50 000 per year.

In 1983 the Plan Project was introduced

A report by the Swedish Tax Agency (which was formed in 1971) was published in 1983, called “Plan-projektet – en strategi för framtiden” (“The Plan Project – a strategy for the future”). The project presented a number of proposals for modernisation and rationalisation, most of which were implemented. Proposals included selective auditing

and a simplified tax return procedure. While these were big changes, the assessment boards were still in existence and much of the spare-time audit activity remained.

In 1992 there was a tax reform and breakthrough of computerisation

Sweeping changes took place in the various tax assessment procedures. The old assessment boards were replaced by tax boards, which were set up to promote greater transparency. A tax authority was formed in every county. In tax actions, the system of assessing the entire tax return and determining the tax to be paid that was employed by the courts was replaced by a system whereby the courts considered only the particular matter that was disputed and the tax authorities determined the tax to be paid. The tax administration was radically reorganised. In the mid-90s computerised audit selection systems were adopted, which for the audit activity meant a whole new way of working.

5.2 What history can teach us

The conclusion may be drawn from the above that in times past the Swedish tax audit activity, to the extent there was any audit activity, was based largely on the audit function having good local knowledge of taxpayers. A tax authority with a good knowledge of its taxpayers does not need to know how common a certain error is at national level, nor is any knowledge needed of the psychological causes of a certain type of behaviour. These things were never analysed, nor was any analysis required. Up until income tax returns were introduced in 1902, a lot of the assessment was done purely by a process of estimation, although in many cases the people who determined the taxation probably knew more about their taxpayers than we do today. The old assessment procedures were rational in relation to then prevailing circumstances.

Personal knowledge assumes that the people conducting the audit have proximity to the persons being audited, as has also been the case. Now, however, we see a development whereby the audit activity may be conducted by a different tax office than the one where the taxpayer actually lives. This trend breaks with many centuries of tradition, so it is not surprising that the change is being made cautiously and not without a certain amount of pain.

This development has been made possible since, today, taxation is in no way based on personal knowledge, although it may still have a certain importance. It is natural, then, to find other sources of knowledge, and so the rational approach is to study the entire taxpayer population in order to identify patterns of error and behaviour.

The introduction of risk management in the year 2000 has very clearly illustrated the need for knowledge. The current method of working based on analysis of the tax gap and taxpayers' behaviour and broken down into risk areas, concludes finally in audit activity or other measures aimed at a particular group.

When the computerised audit selection systems were introduced in the mid-1990s, they were really only doing the same job as the human audit officers, that is to say comparing different sums with one another and with statements of income. When risk analysis arrived, methods and techniques were introduced which it is not possible for humans to carry out: analysis and processing of large amounts of data which only computers can do. This opened up a completely new source of knowledge, knowledge that is absolutely essential in order for a tax administration to be able to do its job.

5.3 Systematic risk management

The basic fundamental of risk management is, therefore, knowledge of the tax gap and the effects of measures taken to close it. Among other things, this requires a functioning business intelligence analysis and evaluation.

Korsell (2002) expresses it as follows:

“Where tax legislation, audit activity and preventive initiatives are concerned, the most important aspect of a structured risk assessment is that it should acknowledge the need for it to be knowledge-based. --- In clear text, it is about providing support for trying to do what is important, and timely, instead of letting everything trundle along as usual.

“For even if the collection of information --- is done with a high degree of scientific methodology, there is a ‘risk’ that the actual risk assessment will be done haphazardly or be dependent on the own experiences, prejudices and preferences of the people involved.

“In actual fact the initial problem is that there is too little primary data that can be used for risk assessment, follow-up and management. Secondly, we are not good at utilising the data that actually exist. Instead, some pretty superficial reporting and coordinating structures have been built up without satisfying the basic need for information and analysis.”

5.4 The importance of knowledge cannot be overestimated

The famous Chinese military strategist quoted in the introduction to this chapter, Sun Tzu, had a lot to say about knowledge.⁷ Among other things, he said that *“The reason the enlightened sovereign and the wise general often win the battle when they move, and their achievements surpass those of ordinary men, is foreknowledge”*.

Sun Tzu also emphasises the importance of spies: *“Of all those in the army close to the commander, none is more intimate than the spies”*; *“Of all rewards, none more liberal than those given to spies”*. He stresses the importance of knowing facts about the enemy and the terrain and draws analogies with previous events. He concludes by saying: *“Knowing the enemy and oneself, one will be invincible”*.

Another very famous military strategist was Carl von Clausewitz⁸. One of his greatest contributions was critical analysis, which involved tracing the effect of something back to its original cause. It was important to evaluate action that has been taken and to consider alternative paths. Theoretical knowledge provided the framework for analysis and assessment.

⁷ The fact that military strategists are quoted does not mean that the work of the tax administration should be regarded as a war. It could possibly be viewed as a fight against the tax gap but never a fight against taxpayers.

⁸ Prussian General (1780-1831), author of “Vom Kriege”.

Even if the idea of tracing an effect back to its cause may seem self-evident, this rarely happens. The reasons for this are, of course, a lack of data for analysis and a lack of time to make the analysis. However, a couple of present-day examples may serve to illustrate the benefit of carrying out these analyses.

For several years in the late 1990s, the Swedish Tax Agency carried out extensive audits of taxpayers who had sold unit trusts registered outside Sweden. The reason for this was that no statements of capital gains had been submitted (for unit trusts registered outside Sweden, but only for unit trusts registered in Sweden) and that tax return errors were common. The audits showed that 40 % of the sales of these offshore unit trusts had not been reported. Major resources went into audit activity and gradually into education and information as well. The proportion of errors did not diminish, however. The evaluations done by the Tax Agency indicated that the errors were unintentional (RSV 2002). The reason why the information did not work was probably that the unit trust holders were not aware that they were offshore funds and so the information did not reach its target. If it had been possible to bring this knowledge to holders at an early stage, far fewer resources need have gone into the audit activity and more effort could have gone into providing information, not that the unit trust must be declared but that the holder had invested in an offshore unit trust. One might speculate as to whether such knowledge might also have helped make the entry of capital gains statements quicker than what was now the case.

Another example concerns claims for deductions of “other expenses” from income from employment (RSV Report 2001:1). The Tax Agency reacted late to the fact that the number of such deductions claimed by taxpayers rose sharply for several years in a row. When it was also discovered that 85 % of the deductions claimed contained errors, major efforts went into audit activity and into educating taxpayers about the audit activity and the rules for claiming deductions. A fall in the number of deductions was noticed locally when the audit activity was very extensive, but at national level no decrease was observed; on the contrary, the deductions went on increasing in number (even if the average amount claimed decreased). So major audit activity was carried out, despite the fact that it was not known (and still is not known) what the underlying causes were of the increase in deductions or why there were so many errors. Follow-up work done subsequently indicates that many deductions were not specified; some taxpayers did not respond to the Tax Agency’s inquiries either, which may indicate that the deductions were an attempt to evade tax (“if it works, it works”). However, the great majority of deductions consisted of expenses for home offices, computers, specialist literature and similar, which in principle might very well have been deductible, even if in practice they seldom are. They may well have been expenses that taxpayers had had and which they regarded themselves as being entitled to claim. In that case they are unintentional errors (supported by the fact that many such deductions were “accepted” by the tax administration). The purpose here is not to argue that the majority of errors are unintentional, but to demonstrate that our knowledge of errors is insufficient: knowledge that is necessary in order for the right measures to be taken to prevent errors occurring.

Audit activity of unintentional errors or unintentional non-compliance is an expensive way of educating taxpayers about the rules that apply and it also means that there is less investigation and auditing of intentional errors or intentional non-compliance. There is a great deal to gain from learning more about the errors that are made, who

makes them and why they make them. It is important to trace the effects back to their original causes, to make evaluations and to find alternative solutions, and to found everything on a sound theoretical basis.

In some cases, however, it can be very difficult to get the knowledge that is needed, and then it is important to be clear about what sort of knowledge exists and what is lacking.

*There is only one thing about which I am certain, and that is
there is very little about which one can be certain.*

Somerset Maugham

6 On the tax gap

In order to reduce the tax gap (the shortfall between theoretically correct revenue and the actual revenue collected) we need to know what it looks like, both as regards its size and its anatomy. We also need knowledge about the different effects of the tax gap. Effective action strategies must take into account both cause and effect in order to achieve optimum results; focusing exclusively on large amounts of revenue will not produce optimum results.

6.1 Size and development of the tax gap

The Swedish tax gap has been estimated at approximately SEK 88 billion, according to a survey done in the year 2000 (Tax Statistical Yearbook of Sweden 2003). This tax gap is equivalent to 4.2 % of GDP or 8 % of the total tax revenue. At the previous survey in 1997, the tax gap was SEK 84 billion and amounted to 4.7 % of GDP and 8.8 % of the total tax revenue. This may be interpreted to mean that the tax gap decreased in relative numbers, but it may also be a result of the uncertainty in the surveys (primarily the estimation of the informal sector). One could possibly draw the conclusion that the tax gap has at any rate not increased. This view is supported by Skattebasutredningen (Tax Base Commission) (SOU 2002:47), which established that the tax gap, measured as a percentage of GDP, has not grown in the past two decades.

Surveys from Denmark and Norway suggest that the spread of the informal economy has diminished in both these countries in the past two decades (Rockwoolfonden 2002, Stiftelsen Frischsentrret 2002).

The results of the taxpayer surveys carried out regularly by the Swedish Tax Agency provide no indication either that tax fraud or evasion is on the increase. The proportion of taxpayers who are prepared to pay their taxes (as long as nearly everybody else does so) has remained largely unchanged since 1996⁹. The proportion who are acquainted with someone who has evaded tax has fallen slightly since 1996¹⁰.

Brottsförebyggande Rådet (Swedish National Council for Crime Prevention) (BRÅ 2001) summarises the results of questionnaire surveys done in 1988 and 2001, concluding that taxpayer morale has increased and that the general public have a less accepting attitude to economic crime.

The figures show that there are no certain indications that the tax gap will increase; instead it remains unchanged or possibly decreasing. This is not the impression we normally get from public debate; frequently the impression given is that tax evasion and fraud are increasing all the time. There is much to indicate that this is a myth. At

⁹ The percentage of respondents who agreed was 72 % in 1996 and 74 % in 2002

¹⁰ The percentage of respondents who agreed was 25 % in 1996 and 21 % in 2002

the same time, we should remember that even if the tax gap is unchanged overall, there may have been major changes within and between different sectors. In other words, the tax gap may have widened in some sectors and narrowed in others. It is reasonable to assume that the ever more highly developed system of employing statements of income has decreased the tax gap, while at the same time errors in connection with international transactions have probably increased.

6.2 Anatomy of the tax gap

What does the tax gap look like? In which sectors is there most tax evasion? Who cheats? These are some questions that can be considered as part of the description of the anatomy of the tax gap.

The bulk of the tax gap, approximately SEK 56 billion, consists of tax accruing on illicit work and undeclared income. The tax gap with international connections amounts to SEK 20-35 billion. The largest groups of companies are responsible for SEK 16 billion of the tax gap (Tax Statistical Yearbook of Sweden 2003).

Tax evasion or fraud is more common among small companies. A survey from the USA showed that 38 % of the small companies surveyed admitted having evaded tax at some time during the past five years. The fewer employees companies had, the higher the percentage that admitted tax evasion (Webley 2002).

In 1987, undeclared income from the self-employed accounted for 28.7 % of the tax gap in the USA (Lederman 2003b).

In the USA, the IRS estimates that voluntary compliance (proportion of those who declare their income correctly) is 79 % for small companies and 90 % for companies with assets in excess of USD 1 million (data from 1983). The lowest compliance, however, is among taxpayers with “naturally invisible” income (known as “informal suppliers”). These are small companies that receive payments (often small amounts) in cash from households. Their degree of compliance is 21 % (Kagan 1989).

Those who attempt to evade tax tend to be young, male, egoistical and with a positive attitude to tax evasion and a negative attitude to the tax administration (Webley 2002). High tax rates, bureaucracy and quarrelsome authorities are generally put forward as reasons why some people choose to take part in the informal economy. Studies show that purchasers of illicit services believe that the sellers of such services hold these views. The sellers believe, but to a lesser extent, that the purchasers hold these views. However, neither purchasers nor sellers regard themselves as holding these views (Schneider et al 2001).

The probability that an individual will purchase illicit work increases with the level of income and education. At the same time, the majority of sellers of illicit services are to be found among low income groups (Tax Statistical Yearbook of Sweden 2003). This is confirmed by surveys from Australia. The people who supply the illicit services tend to be young men, while those who purchase the services are middle-aged and well-educated (Braithwaite et al 2003).

The people who participate in the informal economy as sellers do not constitute a stable group either: their participation changes when their life situation changes. The attitude toward paying tax also varies between purchasers and sellers. Purchasers consider themselves to be honest taxpayers, and believe that taxes should be paid and that the tax administration is fair, to a greater degree than the sellers, who prefer to distance themselves from the tax system. One might say that the purchasers provide the opportunity and the temptation to perform illicit work, but that it is the sellers who must take the moral responsibility for it (Braithwaite et al 2003).

In a study based on a role game (a kind of computer game), the people taking part in the experiment were each asked to run a restaurant, but they were not told that the study was actually about tax. The results showed among other things that the degree of tax evasion was greater in year 2 than in year 1. 44 % paid their tax correctly, 32 % cheated slightly and the rest cheated in a big way. The tax evaders differed from the others on three points: they were more egoistical, they regarded VAT as unfair and they thought that the VAT should be paid from their own money (Webley 2002).

According to a survey done by Riksrevisionsverket (Swedish National Audit Office) in 1997, in Sweden it was estimated that some 650 000 to 800 000 people were engaged in illicit work (RRV 1998:28). These people worked on average five hours per week. Men carried out more illicit work than women, and among the actors most well-represented on the illicit labour market were the self-employed and students.

The Danish Rockwoolfonden's research unit (Pedersen 2004) has compared the prevalence of illicit work in a number of countries. The following diagram shows the results broken down by category of employment.

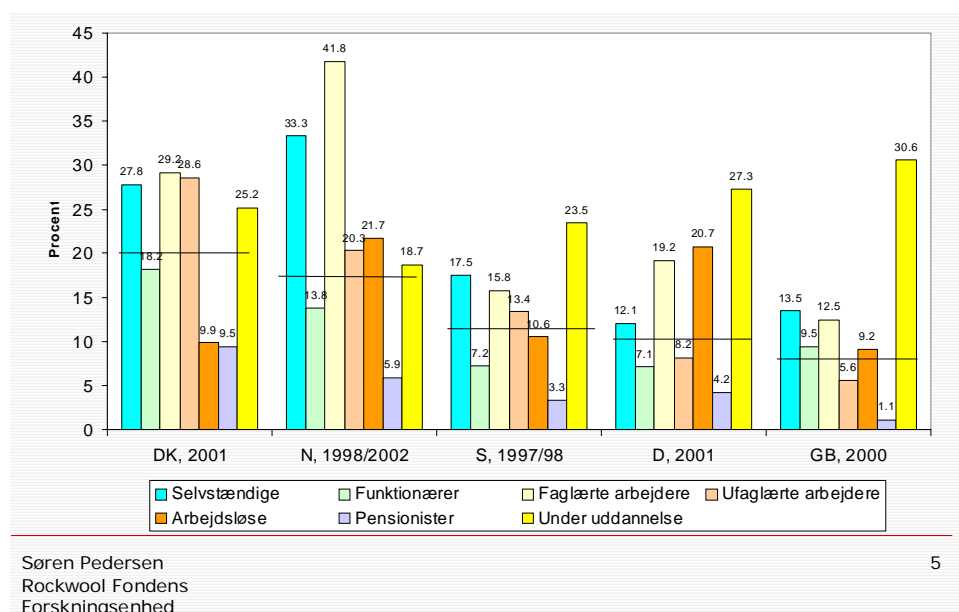


Figure 6.1 Proportion of the population aged 18-74 who carry out illicit work in Denmark, Norway, Sweden, Germany and Great Britain broken down by category of employment

The different employment categories surveyed are the self-employed, salaried employees, skilled workers, unskilled workers, pensioners, students and the unemployed. This confirms the picture that it is students and the self-employed who

account for most of the illicit work. In total, illicit work in Sweden is equivalent to 94 000 full-time jobs.

There is much to indicate in other words that it is the self-employed or employees of very small companies who account for most of the illicit work carried out. The number of persons employed in the various categories is as follows¹¹:

<u>Category</u>	<u>Number of employees in total in millions</u>
Companies with < 20 employees ¹²	1
Companies with 20 - 200 employees	0.6
Companies with > 200 employees	0.9
Public sector	1.3

It is unlikely that employees of large companies or the public sector carry out illicit work (in these jobs).

A Norwegian study points to the following link between illicit work and the number of company employees (Stiftelsen Frischsentret 2002). (Svart arbeid = Illicit work, Antall ansatte = Number of employees, Industri, Bygg og anlegg mv = Industry, Building & Construction etc, Annen tjenesteyting mv = Other Service Industries etc)

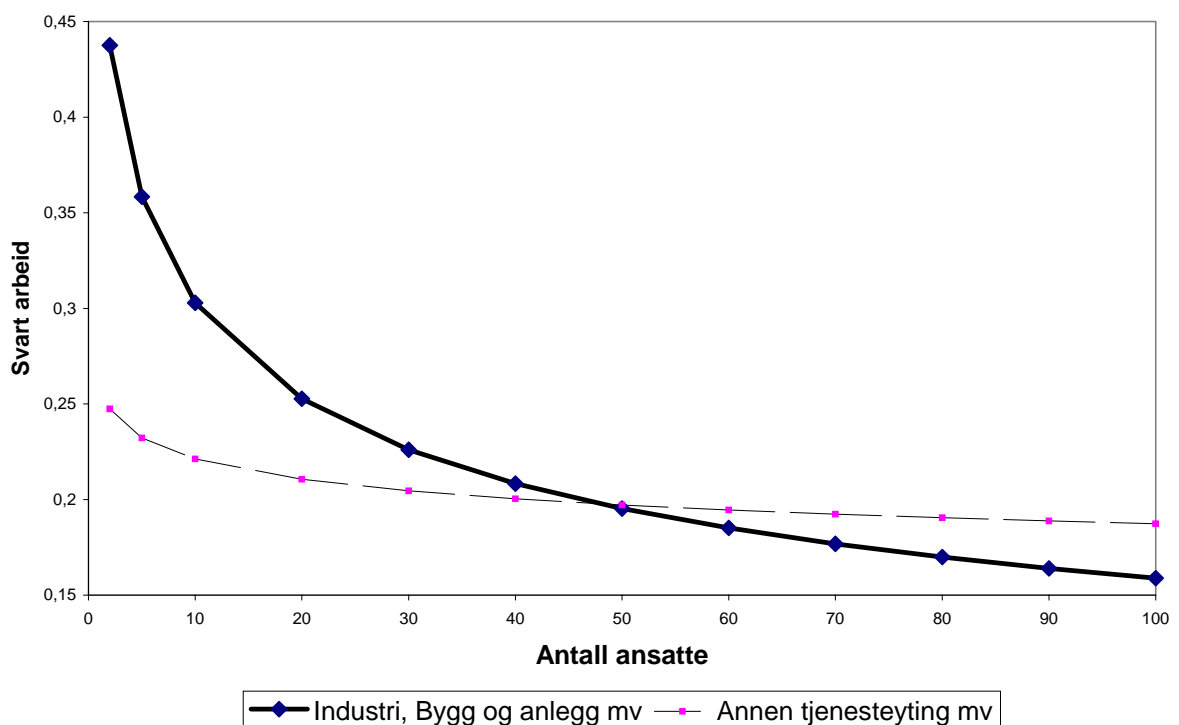


Figure 6.2 Link between the likelihood of illicit work occurring and the number of company employees in Norway according to Stiftelsen Frischsentret 2002

¹¹ The figures have been calculated with the help of information from the Swedish Federation of Private Enterprises and Statistics Sweden (SCB). Agriculture is not included in the term “companies”, which is why the number of small companies is estimated as low.

¹² Including companies without employees.

The conclusion is that the self-employed and small companies with few employees account for the bulk of the tax gap.

There is also a considerable gap among large companies. However, the gap is of a different nature and frequently arises as a consequence of advanced tax planning, which is not obviously wrong. Of the adjustments made, however, approximately 75 % are upheld after court decisions (Tax Statistical Yearbook of Sweden 2003). Large companies try to comply with the rules of the game but stretch the limits and exploit grey zones in the legislation. Against this background, John Braithwaite (2003) proposes strategies that combine audit activity with a variety of legislative measures.

In the case of medium-sized companies, the picture can be different: illicit work does not occur to any great extent there, either, but medium-sized companies do not have the same resources or expertise as the big companies when it comes to advanced tax planning. One might, therefore, speculate as to whether medium-sized companies do not demonstrate greater compliance.

The number of large and medium-sized companies in Sweden is small compared with the number of small companies (99.2 % of companies have fewer than 50 employees according to the Swedish Federation of Private Enterprises 2003). This means that the average gap per company may be greater in the case of large and medium-sized companies than for small companies, despite the fact that the overall tax gap is greatest among small companies. This is a factor that must be taken into account when selecting companies for audit, since endeavours to find a big gap leads to increased auditing of large and medium-sized companies at the expense of auditing small companies.

6.3 Effects of the tax gap

Is the size of the tax gap a measurement of the amount of revenue that the Government loses because of tax evasion?

This question is disputed by researchers. Some believe that tax evasion or fraud in the form of illicit work generates income which is consumed and which is ultimately taxed. The damage is then slight or non-existent. Others believe that tax evasion is always tax evasion irrespective of what the money is used for, in the same way as a bank robbery is always a bank robbery even if the money is consumed or deposited in the bank in question.

The Government also has the opportunity to increase taxes in order to get the money it needs (within reasonable limits). In that case, tax evasion means a redistribution of the tax burden from dishonest to honest taxpayers but not to any total loss of tax revenue.

The following example may provide further illustration:

In a little place in Sweden a man works helping pensioners with snow-clearing, lawn-mowing, leaf-raking and similar things against payment of a small cash sum. The work is done illicitly, since it would otherwise be too expensive. There is only a large enough customer base for one person to do the work. Everyone in the village is satisfied, the pensioners get the

help they can afford and the individual performing the services can make a living. In this situation there is no unfair competition and if the work were to be taxed it would not be carried out at all and the individual would be claiming unemployment benefit instead.

What is the Government's loss because of this tax evasion? If the basic assumption is that the Government wants to get in a certain amount of tax revenue and it adjusts the tax rate schedules up or down to allow for tax evasion, then, purely theoretically, the following applies: *It is better that work is being carried out than not being carried out, irrespective of whether the work is taxed or not.*

In the example above, the variant with the unemployment benefit is the worst outcome for everyone involved, including the Government, which will incur additional expense. If this expense is to be paid by increasing taxes, this will involve taxpayers (the pensioners in the example) incurring an additional expense despite not having had any work carried out. Illicit work can thus be better than no work at all. This applies under the assumptions described above. The effect may be different if the illicit work has a negative impact on competition, norms or trust.

How, then, does illicit work compare with licit work? If the income from the services mentioned in the example above was to be taxed, the services would be more expensive, but since the Government would then collect more revenue the taxes could be lowered (all other things being equal). This lowering of tax is equal to the additional cost that results from the work being done licitly and the income declared. For taxpayers as a whole, there is thus no more expense involved with licit work. It also means a lowering of tax, which should benefit employment (all other things being equal) and thus the economy in general. *It follows from this that licit work is always better than illicit work.*

Taxation affects not only whether work is licit, illicit or not done at all, but also in which sector or trade the work is done. Let us assume that a person can choose between working as an employee and working as a sole proprietor of his own business. As an employee, he will earn SEK 200 000 and as a sole proprietor his income will be SEK 180 000. If the tax is the same in both cases, the individual should choose to be an employee, but since a sole proprietor will have greater opportunity to evade tax, the real tax charge may in that case be lower. The occurrence of tax evasion can therefore result in resources being allocated in a way that is not optimal for the national economy. The consequence will be lower productivity.

The fact that tax-evading companies with low productivity can out-compete honest companies with higher productivity is also negative for the economy. A study from Norway suggests that the more tax evasion there is in a company, the lower the productivity (Stiftelsen Frischsentret 2002).

Illicit work can even lower the level of education, which in the long term can impact negatively on the economy (Kolm and Larsen 2004). Unskilled workers carry out more illicit work than other categories of workers. The probability that an individual will do illicit work decreases with the length of his or her education. When the opportunity is given in society for illicit work in sectors where theoretical education is not required,

such education becomes less attractive. Illicit work means that fewer people choose to be educated to a higher level than would otherwise be the case.

A reduction in illicit work should lead to more people obtaining training and education and to unemployment rates falling. The main reason why unemployment falls if the extent of illicit work is reduced is that there is a redistribution of the labour force to the licit employment sector. This reduces unemployment, as the work in the licit employment sector has on average a longer lifetime than illicit work.

IFS (The Association of International Entrepreneurs in Sweden) (IFS 2003) takes the view that illicit work hinders growth since it makes it difficult to get access to legitimate finance (which is a prerequisite for growth).

Korsell (2003) believes that it is not primarily the direct economic effects of economic crime (even if they are considerable) that is the biggest problem, but that public trust and confidence is adversely affected. Economic criminality gives rise to distrust and a lowering of moral values, which leads to a dissolution of social norms.

There are thus a number of different effects arising from tax evasion. The detrimental effects of tax evasion are described in the Tax Statistical Yearbook of Sweden 2003 as follows:

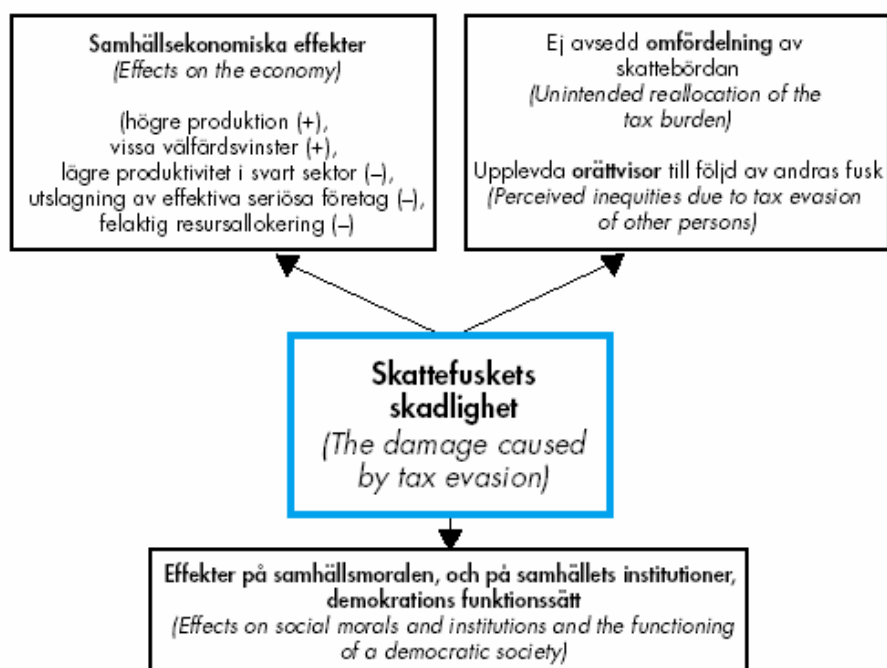


Figure 6.3 The damage caused by tax evasion according to the Tax Statistical Yearbook of Sweden 2003

Fig. 6.3 above shows that the damage caused by the direct economic loss sustained by the Government in the short term because of tax evasion is not the most serious aspect. Considerably more serious is the fact that tax evasion reduces growth (and thus also future tax revenues) and has a negative impact on social morals. If taxpayer morale is

worsened, reactive measures (audit activity) cannot solve the problem. What is needed are proactive, preventive measures.

6.4 Some structural causes of the tax gap

In previous chapters we have touched on human behaviour as being partly the cause of tax evasion. In addition to this, we also need to look at structural causes and their connection with norms and behaviour.

We can never tackle tax evasion successfully unless the underlying causes of it are known. In all likelihood it involves an interplay of a number of different factors and we can never have total knowledge. However, our ambition must be to obtain the best possible knowledge in order to take the right type of action to close the tax gap.

There are of course more structural reasons for the tax gap than those mentioned here. The point here is to show that there may be underlying factors that are not always evident and that there is value in attempting to identify and map them.

6.4.1 Visibility of transactions

Sociologists believe that the opportunity to observe a behaviour, in other words its visibility, is decisive for the way in which a social group adapts to the prevailing norms. Social disapproval can only be expressed if the deviant behaviour is known.

The same applies to legal norms, that is to say that errors and tax evasion that are not visible to the authorities are more common than more visible tax evasion. Tax evasion thus varies according to the degree of visibility or the frequency with which it is detected by the authorities.

The visibility of a taxpayer's transactions increases if there is an obligation to give information to the tax administration. The value of this information is greatest if the data in question leaves some third party record or audit trail that the tax administration can use for purposes of comparison. The connection between the visibility of different transactions and the degree of tax evasion can be described as follows (Kagan 1989):

1. **Tax withheld at source**
Very little cheating
2. **Information reported by a third party**
Somewhat more cheating than in case 1, but still very little cheating
3. **Accounting or other information that can be audited**
Considerably more cheating. Many pieces of information can be compared with third-party information, but only with difficulty and to a limited extent.
4. **Cash transactions**
Cheating increases further. Cash transactions leave no third-party trail.

It is a well-known fact that tax evasion is greatest in cash-based businesses such as restaurants, hairdressers and taxi firms (not only in Sweden but also abroad).

Experience from the Taxpayer Compliance Measurement Program in the USA shows that only 1.8 % of taxpayers declared low dividend income of more than USD 2000. Income statements are provided for dividends. In the case of self-employed persons, 22 % had undeclared income of over USD 2000 (1979 income year) (Kagan 1989).

Unreported income is a big problem with regard to visibility and tax evasion. The following different types of unreported income occur:

Degree of visibility	Type of unreported income
Potentially visible before audit	1. Unreported income reflected in documents and reports submitted directly to the Tax Administration
	2. Unreported income discoverable by the Tax Administration through audit of third party records
Potentially visible only upon audit	3. Unreported income discoverable only through audit of taxpayers' records
	4. Unreported income discoverable only by Tax Administration discovery and analysis of taxpayers' assets
Potentially invisible even upon audit	5. Unreported income concealed from normal audit due to fraudulent record keeping
	6. Unreported income concealed from normal audit by natural invisib. (e.g. cash income from households)

Figure 6.4 Link between unreported income and visibility according to Kagan (1989)

It becomes increasingly difficult to keep transactions invisible when companies grow and get even bigger. When employees come into the picture, insurances and pensions are required, and there are other factors, too, that leave a third party trail. Frequently, irregularities must also be kept concealed for employees, which can be very difficult, otherwise there is the risk that they will give information to the tax administration. Investment activities often require a bank loan, which both makes demands of record keeping and leaves a third party trail. There is thus an antagonism between growth and invisible transactions (Kagan 1989). This explains why tax evasion and fraud decrease when companies get bigger, while at the same time reinforcing the picture that tax evasion hinders growth.

The tax administration may thus have an interest in increasing transaction visibility. Visibility depends on the following factors:

- opportunities for inspection
- how the opportunities are exploited
- information about the tax administration's opportunities to use third party information

If transactions can be checked against third party records, tax evasion will decrease even if the opportunities for checking are not exploited. Tax evasion can also be

affected by information being spread about the opportunities for use of third party records by the tax authorities.

6.4.2 The post-industrial dilemma or Baumols disease

At the end of the 1960s, the economist William Baumol demonstrated that productivity rises much more rapidly in industry than in parts of the services sector. This means that certain services become relatively speaking more expensive; this has also been called the post-industrial dilemma.

Compare, for example, a symphony orchestra with a manufacturing industry. In the manufacturing industry, productivity has increased sharply in the past 100 years. A symphony orchestra, however, needs just as long to play a certain piece today as it did 100 years ago. The members of the orchestra are also entitled to wage increases at the same rate as the rest of society. This creates an imbalance and a problem for sectors where there can be no increase in productivity.

A less extreme example is that of restaurants and hairdressing businesses. While there has of course been a certain development in productivity within these sectors, it cannot be compared with the developments that have taken place in industry. It takes just as long to cook and eat a steak today as it did 100 years ago; a haircut also takes approximately just as long (even if machines are used). However, employees in restaurants and hairdressing businesses also want wage increases on the same level as other sectors; this makes demands on them to raise their prices or cut their costs. They cannot raise their prices too much and there is also a limit to cost-cutting. In such a situation, the business concerned may view tax as the only cost left to minimise, and tax evasion may be a fact. The business may have had no intention to evade tax at the outset, but circumstances may lead it into a situation where it is viewed as the only possible way out.

This explanation does not apply to all sectors, however (it would hardly apply to the construction industry) and it cannot be the only explanation.

If this explanation has any significance, it is interesting to note that if tax evasion is combated by, for example, increased audit activity, the post-industrial dilemma will still remain and create problems in the industry (which presumably means that a strategy focused solely on audit activity will not succeed). This underscores the importance of tackling the causes of the problem and not merely the symptoms. If there are multiple causes (which is usually the case), all the causes should be identified and tackled as far as possible.

The post-industrial dilemma also indicates that what is required is changes to the system as a whole in order to get to grips with specific problems.

6.4.3 Impact of the tax burden on tax evasion

Does the tax burden have any importance for the extent of tax evasion? There is nothing to indicate that there is a direct link. The following diagram shows the extent of illicit work and the tax burden in a number of countries (Pedersen 2004).

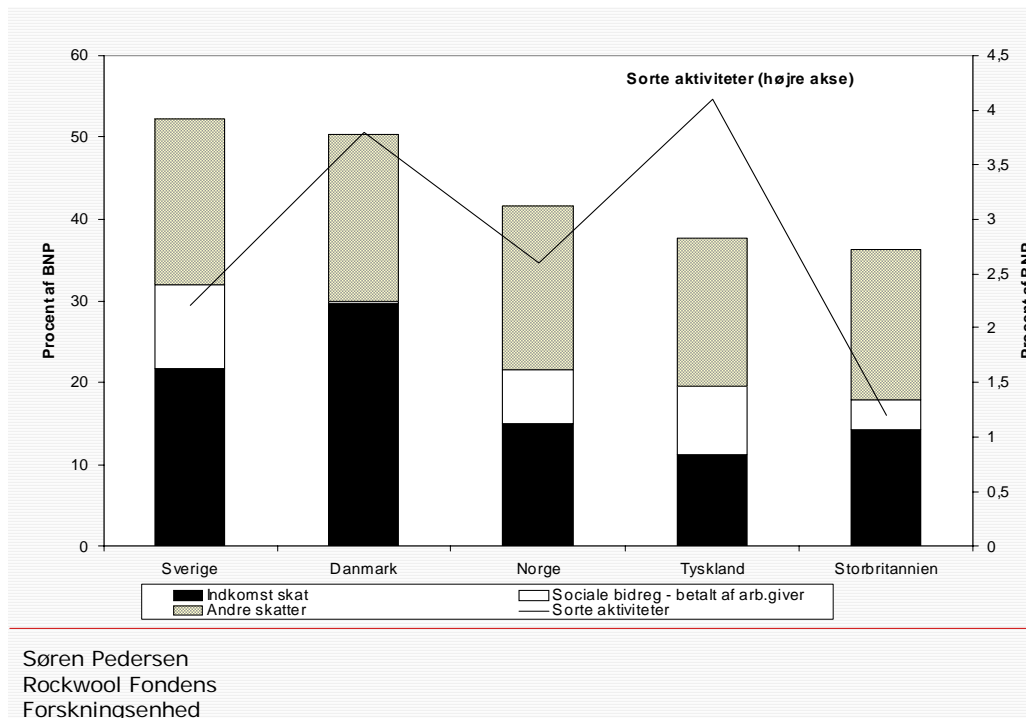


Figure 6.5 The tax burden and illicit work in Sweden, Denmark, Norway, Germany and Great Britain.

The line shows the extent of illicit work as a percentage of GDP (right axis) and the bars show the tax burden as a percentage of GDP (left axis). Sweden has the highest tax burden but a very low level of illicit work. Germany has a considerably lower tax burden but a high level of illicit work.

Edlund and Åberg (2001) believe nevertheless that the tax burden may be important since the incentives and opportunities for tax evasion are greater in high tax countries than in low tax countries. They have identified a link between the tax burden (as a percentage of GDP) and the level of taxpayer morale (the percentage of people who think that tax evasion is never acceptable). The link is stronger if Japan, Austria, Denmark and Sweden are excluded, since these countries have higher taxpayer morale than what might be expected considering their tax burden. There are also examples of countries with a low tax burden and low taxpayer morale.

Since Edlund and Åberg have been obliged to exclude a large number of countries in order to produce a link, the argument is not convincing. It is probably not as easy as the existence of a direct link between the tax burden and tax evasion. The tax burden may nevertheless have an indirect effect on taxpayer morale.

Edlund and Åberg (2001) may, however, be on the track of something here when, instead, they compare tax evasion with political stability. In countries that have been dominated by left-wing governments, the tax burden is higher than in countries dominated by right-wing governments. Notwithstanding, the data does not support the claim that taxpayer morale should be lower in countries dominated by left-wing

governments. On the other hand, political stability is important. In countries where one political party dominates, taxpayer morale is higher than in countries governed by coalitions.

The conclusion is that an effective tax policy that is in line with public opinion results in higher taxpayer morale. This means that a high tax burden which is accepted by public opinion does not impact taxpayer morale negatively. On the other hand, a low tax burden that is not accepted by public opinion results in lower taxpayer morale. The decisive factor is not, therefore, the level of the tax burden but whether or not it is accepted by public opinion.

6.5 Action strategies

6.5.1 The tax administration's primary responsibility

While the tax gap has not grown in recent decades, it has not lessened either (at least not to any great degree). This indicates that the Swedish Tax Agency has not failed, yet nor has it succeeded, since one of its most important tasks is to reduce the tax gap.

The task of reducing the tax gap must not, however, lead to lower tax revenue in total as a result of decreased growth, which may be the case if the Tax Agency concentrates solely on closing the tax gap at any cost.

A tax administration can act so that illicit work becomes licit, which is positive, but a tax administration can also act so that illicit work becomes no work at all, which can be negative. Licit work involves not only impositions in the form of taxes but also administrative impositions. While an excessively zealous tax authority may succeed in reducing the tax gap considerably, it may have a detrimental effect on public welfare and reduce government revenues.

A tax official in the USA is reported as having said the following (James et al 2001):

The maximising of revenue is not a priority. The priorities are compliance and making an example of delinquent taxpayers through seizure... This attitude of punishing citizens permeates the entire management cadre. The manager... has stated that he does not care if he has to close up half of the businesses in order to get compliance.

This indicates that a tax administration cannot regard reducing the tax gap as its primary task in isolation from other considerations.

The purpose of increasing compliance in the tax system is linked inevitably to the purpose of collecting tax. Strategies for increasing compliance must, therefore, be an integral part of a broader taxation policy (James et al 2001).

The tax administration has its duties to perform and there must be no political overtones to its actions, but nor can it act in a manner which, if it comes to the worst, is counterproductive to the purpose of collecting tax.

There may be cause to reflect on whether the overarching objectives of the Swedish Tax Agency as expressed in its spending authorisation are formulated so as to embrace a broader view which includes questions of public welfare and trust.

The Australian tax administration has, for example, stated its mission as follows: “*To optimise collections and make payments under the law in a way that instils community confidence that the system is operating effectively*”. Here, it is a matter of maximising tax collections while at the same time maintaining the general public’s trust and confidence in the system.

The IRS in the USA has the following mission statement: “*Provide America’s taxpayers top quality service by helping them understand and meet their responsibilities by applying the tax law with integrity and fairness to all*”. There is nothing in this statement about either tax collections or tax evasion.

6.5.2 Audit activity and information

An interesting question is also how the above considerations impact on the current strategies for audit activity, education and information.

The question is whether it is possible with the existing resources to increase the number of field audits of smaller companies without decreasing the audit activity’s presence in the field for medium-sized companies? By combining more limited field audits with educational visits in the field, the equation can, however, add up. Educational visits in the field have the advantage of creating a visible presence, while at the same time helping companies to get things correct from the start. Medium-sized companies are probably particularly well-suited for visits from tax educators. They have premises and usually their own finance and accounting staff, and they also evade tax to a lesser extent than small companies. They are also likely to have a greater need for education and information than big companies.

One possibility might then be that some of the resources that go into more extensive field audits of medium-sized companies could be divided up and used for educational visits to medium-sized companies, greatly delimited field audits of medium-sized companies, and field audits of small companies.

This would permit the audit frequency of small companies to be increased without the preventive effect in medium-sized companies being lost (it could even be improved because the number of companies visited would increase).

In addition to field audits, it should naturally also be considered how best to distribute desk audits, and how other measures could be used.

For ordinary wage-earners, it is important to influence norms and to spread knowledge that most taxpayers are honest but that the vast majority of tax evaders are caught.

6.6 Conclusions

One conclusion is that alarmist reports of a sharp increase in tax evasion should be taken with a pinch of salt: at any rate, all such claims must be able to be substantiated

by some form of facts. Even if tax evasion has not increased, viewed overall, the structure of tax evasion has probably changed and will go on changing.

It may be necessary to adjust the focus in connection with risk values and priorities to take greater account of the fact that a reduction in economic growth and public welfare is one of the biggest problems resulting from tax evasion.

The extent to which different transactions are visible influences the degree of tax evasion. The more easily a tax authority can check something, the less tax evasion there will be in a particular area. In addition to statements of income submitted to the Swedish Tax Agency, it also has the possibility of obtaining information from third parties by means of injunctions or field audits. By using this possibility to a greater extent, but principally by providing information about the possibilities and relaying the results from activities carried out, the perceived visibility of transactions may increase.

Another conclusion is that small companies are responsible for a large part of the tax evasion that goes on, but that the average tax gap can be greater in large and medium-sized companies. Medium-sized companies demonstrate high compliance, while at the same time being the group that are audited most. The distribution of audit and educational activities between medium-sized and small companies is probably not optimal.

*Criticise yourself as you would criticise others,
and excuse others as you excuse yourself.*

Chinese proverb

7 On unintentional non-compliance

The various chapters in this report do not deal solely with intentional non-compliance, even if the focus, for natural reasons, is on intentional non-compliance as regards questions concerning the underlying causes and understanding of why tax evasion occurs. It is important to understand the reasons behind different taxpayer behaviours that are conscious, that is to say intentional. Unintentional non-compliance that occurs unconsciously, i.e. when an individual believes himself or herself to have acted in one way but has actually acted in another way, is something quite different. Intentional non-compliance also accounts for the overwhelming bulk of the tax gap (more on this below) and represents a much bigger problem because it represents a threat to the entire system. It is also more difficult to tackle. It is therefore entirely natural for the focus to be on intentional non-compliance. However, this does not mean that one should fall into the trap of neglecting unintentional non-compliance. The importance of also paying attention to unintentional non-compliance will be discussed below.

7.1 What is unintentional non-compliance?

Non-compliance that is unconscious, that is to say that is not deliberate or wilful, is clearly unintentional non-compliance. Many tax rules are complicated or ambiguous and are also frequently changed. Thus, unintentional non-compliance can occur through ignorance.

Many people are also uninterested in tax matters and may not always care what is right or wrong in every situation (termed “lazy non-compliance” by Kidder & McEwen 1989). This lack of interest may result in a type of non-compliance that lies on the borderline between unintentional and intentional, in that the individual in question does not know what error he or she has committed but is still aware that there is probably an error.

Other variants of “lazy non-compliance” occur when the person filing his income tax return makes a stab at guessing an appropriate amount when, for example, declaring the purchase value of shares or when claiming deductions, so as to make the amounts agree fairly well with the reality. This is not done with the intention of avoiding or evading tax, but happens because the person either won't or can't be bothered to acquaint himself with the rules, dig out all the records required, and do all the calculations needed. The individual wants to do the tax return quickly and simply and is satisfied if it looks reasonably right (rather a few minor errors than spend hours slaving away at a boring chore).

This lack of interest can also result in non-compliance to both the advantage and disadvantage of the taxpayer. A study from the USA (University of Arkansas 2003) shows that 33 % of taxpayers who intentionally ignored the obligation to file a tax

return knew that they were actually entitled to a small tax refund: they did not consider it worth the effort to file a return.

Kidder & McEwan (1989) also employ the term “habitual non-compliance”, that is to say errors or non-compliance committed out of habit. A typical example is when a taxpayer does a return on the pattern of the previous year’s return. Everyone involved in checking tax returns knows that it is not unusual for errors to be made because the present return is based on last year’s return. This can occur even when the tax administration has corrected the previous year’s return (for example, changed a deduction). When the correction was made, the taxpayer may perhaps not have understood what the mistake was about and then when it is time to do next year’s return, it has already been forgotten. The problems are evident if lazy non-compliance is combined with habitual non-compliance.

Even if minor errors are committed to both the taxpayer’s advantage and disadvantage, it is perhaps not equally as likely for the taxpayer to make major errors to her own disadvantage. It is not unreasonable to imagine an individual who is consciously careless with her tax return perhaps simply guessing at or rounding off figures that will at least mean not having to pay too much tax (in cases where the taxpayer can be bothered to file a tax return). However, there is no evidence of this occurring.

The term unintentional non-compliance should also probably include non-compliance like that described above which, while perhaps not being wholly unconscious, is still committed without the intention to avoid or evade tax.

7.2 Does unintentional non-compliance create a tax gap?

It may be asserted that unintentional non-compliance does not result in any overall tax gap since errors to the taxpayer’s advantage and disadvantage will cancel each other out. This is an entirely logical conclusion if we assume that the error is completely unconscious and that the possibilities for making advantageous errors are just as great as for making disadvantageous errors.

With the expanded importance of unintentional non-compliance as described above, there should still be a preponderance of errors to the taxpayer’s advantage among the unintentional errors.

If we also take into account the various possibilities that exist for committing errors, the picture can be changed further.

Transfer errors are common (when a sum is to be transferred or carried over from one box on the tax return to another) and are often unintentional (done out of ignorance or because the person doing the return thinks it is unnecessary to transfer the amount). However, it is more common for income and profit to be transferred than deductions and losses, which result in more errors to the taxpayer’s advantage than disadvantage.

If the possibilities for committing errors to the taxpayer’s advantage are greater than those for committing errors to the taxpayer’s disadvantage, this should be taken into account when calculating the size of the tax gap caused by unintentional non-compliance. There may be reason to assume that unintentional non-compliance creates

a considerable tax gap. However, further studies are needed in this area in order to confirm this.

7.3 Causes and effects

Unintentional non-compliance is caused to a very great extent by the complexity of the tax rules (McKerchar).

This complexity arises from or consists of one or more of the following components (McKerchar):

- Ambiguous rules (where there are several possible interpretations)
- Calculations (many or difficult)
- Changes (many changes to the rules)
- Details (many rules and many exceptions)
- Obligation to submit records (special records must be kept)
- Forms (difficult to understand)

Studies demonstrate a correlation between the degree of complexity and the level of the taxpayer's conviction of having filed a correct tax return. There is also a link between the degree of complexity and the level of compliance costs. An increase in complexity results in a decrease in the perceived fairness of the tax system while at the same time compliance costs increase. This in turn results in reduced willingness or commitment to compliance with the tax system (McKerchar). The following diagram illustrates this link.

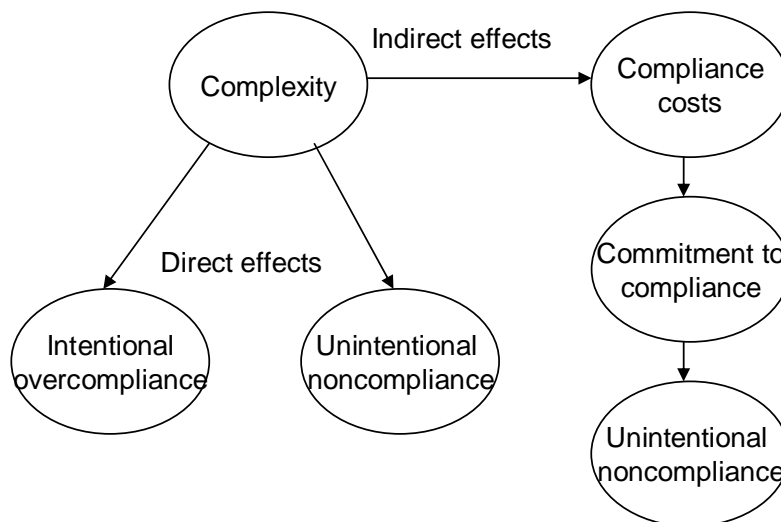


Figure 7.1 Effect of complexity on unintentional non-compliance according to McKerchar

As mentioned in previous chapters, the perceived fairness of the tax system has a direct effect on the commitment to compliance, which means that complexity also has an effect on intentional non-compliance.

7.4 Twofold gain from reducing unintentional non-compliance

Unintentional non-compliance can, then, be reduced by reducing complexity. At the same time, endeavours should of course be made to provide support and help to explain the actual rules to taxpayers. The one (service, education and information) must not be seen as an alternative to the other (simpler rules), but both methods of approach are required. The best approach is to prevent the problem from arising at as early a stage as possible, for which reason simple rules are to be preferred, although the rules should nevertheless be difficult enough to necessitate a well-developed system of service to taxpayers.

Reducing the amount of unintentional non-compliance will reduce the tax gap, while at the same time reducing compliance costs. The perception of fairness will increase, which will also have an effect on intentional non-compliance.

There is yet another major gain to be had from preventing unintentional non-compliance. The audit activity resources that are employed today to correct unintentional non-compliance could be used instead to detect intentional non-compliance.

By preventing unintentional non-compliance, we can also reduce intentional non-compliance considerably. Taking action to reduce unintentional non-compliance appears particularly urgent when one also takes into account the fact that unintentional non-compliance is easier to prevent than intentional non-compliance.

7.5 Possible measures

Possible measures to reduce unintentional non-compliance can in the main be divided into three different categories where all the measures should be employed simultaneously.

1. **Development of simplification proposals.** This is already taking place today, but more attention should be paid to it and it should also be better coordinated with other measures to reduce the tax gap. There should be cooperation with various interest organisations in order to form a picture of which rules taxpayers find most difficult to understand. Questionnaires or focus groups could also be employed for this purpose.
2. **Service, education and information.** Service, education and information can be provided via different channels and in different ways. The scope of educational visits in the field should also probably be increased. More knowledge is needed of how to achieve the optimum effects.
3. **Simpler forms and brochures.**

No man is justified in doing evil on the grounds of expediency.

Theodore Roosevelt

8 On crime

What has been previously described as the causes of tax evasion and different taxpayer behaviours naturally also applies to what is classed as tax crime. The difference between “ordinary” tax evasion and tax crime is not a question of type but of degree. The same basic factors should, then, govern behaviour, but there can be a difference. There is probably a moral distinction between cheating on tax in a small way and committing tax crime (even if the borderline does not coincide with the legal distinction), which can mean that there are special reasons for crime. There has also been extensive research done into crime. It is interesting, therefore, to study the research done into economic crime, partly in order to combat tax crime, and partly in order to utilise those elements of the research that can also be applied to the kind of tax evasion behaviour that is not classed as crime.

8.1 Why do people commit crime?

There are many theories as to why people commit crime. Some of them are referred to below.

Brottsförebyggande Rådet (Swedish National Council for Crime Prevention) (BRÅ 2003:1) refers to the work of the economic crime researcher James Coleman, who believes that economic crime can be explained by three factors:

1. Motive
2. Neutralisations (counteracting excuses)
3. Opportunity

With regard to motive, economic criminals can be divided into individuals who react to crises and individuals who are opportunists. The reactive individual responds to some form of noticeable crisis which the opportunist does not, whereas the opportunist has the will to take advantage of a specific opportunity that renders crime possible.

Korsell and Nilsson (2003) present three different motives for why we comply with the law: calculating motivation, normative motivation and social motivation.

Calculating motivation means that the individual weighs up the pros and cons of complying with the law. The risk of detection is more important than punishment. The commitment of business-owners to comply with the law is influenced by the costs of being law-abiding, such as more costly administration, costly investments, delays or reduction in manufacturing or production. This is why small business owners, subcontractors and companies with poor finances are more likely to break the law than companies that operate under better conditions.

Normative motivation is the combination of a moral duty to comply with the law and how legitimate the law is perceived as being. Several studies show that law-abidingness increases when the individual feels a moral duty to comply with the law. Law-abidingness also increases when laws are perceived as being fair and being applied fairly and are also being complied with by other citizens¹³.

Social motivation means that the individual complies with the rules in order to be accepted by others in his or her social environment. Where the opinion of family members, neighbours, workmates and superiors is important for the individual, factors that threaten these relationships will also have a deterrent effect.

To the economic criminal, being able to explain the reason for the crime is regarded as an important part of the motivation for committing it. Economic criminals normally share the same values in general as the rest of society, but there are mechanisms that weaken their sense of moral duty to comply with the law. The vast majority of citizens, certainly 99 %, view themselves as law-abiding in principle, according to Professor Jerzy Sarnecki (DN 2004). The fact that they are honest people is part of their self-image. When they nevertheless break the law subsequently, they resort to some suitable excuse. These excuses function as important motivational factors since they are used prior to committing the crime. Examples of such rationalisations are that “the crime won’t impact on the poor” or “everybody else does it” (Korsell and Nilsson 2003).

In order for a crime to be committed, a situation wherein the crime can be committed or an opportunity to commit the crime must also be present. The opportunity for crime is created by, for example, the way in which legislation is framed, by complicated business transactions, or by the way in which audit activity functions are designed. Although the opportunity to commit a crime is an important factor, even in the absence of opportunity a strongly motivated perpetrator may attempt to create opportunity.

The structure of opportunity may be illustrated by the following example:

- It is easier for large companies to comply with rules than small companies.
- The pressure of competition affects a company’s law-abidingness, and if the pressure is too great the natural solution may be to reduce costs by not complying with all the rules.
- The placing of a company in the contract chain or hierarchy affects law-abidingness. Small companies and subcontractors may violate rules as a result of the pressure to compete.
- The importance of price for a deal affects law-abidingness. If the price is crucially important there is a risk that competing companies will overlook rules and norms in order to win the contract.

Not everyone who has the opportunity to commit a crime will do so: there are several causes that need to work together simultaneously in order for a crime to be committed.

¹³ One may reflect on whether these are two separate factors (duty and fairness respectively) or if they work together. It is probably the case that with respect to rules fairness creates or contributes to the feeling of moral duty.

However, opportunity is always a temptation that different people may have difficulty in resisting.

An underestimated driving force behind crime is the fear of failure, which can be greater than avarice and the desire for gain (Korsell 2002). This means that crime is likely to be more common when a business is doing badly than when it is doing well.

Norms and informal rules can both deter and encourage criminal behaviour. Occupationally related cheating is often governed by informal rules: one must not cheat too much, nor too little (Korsell 2002).

According to the routine activity theory¹⁴, a crime requires three factors to work together in time and space: a motivated perpetrator, a victim or suitable target, and the absence of capable guardians of the law. Capable guardians of the law may be different types of checking or monitoring systems or, for example, consumers who demand a receipt (Korsell 2002).

8.2 What does the economic criminal look like?

A Swedish study (BRÅ 1996:10) has established the following characteristics of the average economic criminal (based on *convicted* criminals in Sweden):

The average economic criminal is a man in his forties. He is a Swedish citizen and owns a small business. He either has no previous criminal convictions or has had legal proceedings commenced against him on only very rare occasions. He grew up and lives in settled social circumstances, but has the usual financial problems. The economic criminal does not take drugs but tends to over-consume alcohol.

It is easy to imagine how a small business owner or self-employed individual who experiences financial problems may be tempted to commit crime in order to salvage the situation. Such an individual has the motive (rescue the firm and his livelihood), the opportunity (business owners and the self-employed have more opportunity to cheat than private individuals) and can easily find excuses (protecting the family's livelihood and one's life's work can excuse a criminal act, even if one realises it is wrong).

In a later study, Brottsförebyggande Rådet confirmed these earlier results and developed the picture further (BRÅ 2003:3). The majority of people who are convicted of crimes against the Swedish Tax Crimes Act are middle-aged men who have committed the crime within a business framework. Most of the criminality involves VAT fraud, incorrect reporting or failure to report tax on employees' pay, book-keeping irregularities, or incorrect income tax returns or failure to file a tax return. Tax criminality frequently involves considerable sums of money¹⁵ (generally more than SEK 100 000 per crime), which is in stark contrast to the assets acquired by most people convicted of theft.

¹⁴ The routine activity theory was developed by Choen and Felson in 1979. It is based on individuals' everyday routines and occupations: for example work, leisure time, travel or social intercourse with other people.

¹⁵ According to the BRÅ Report 2003:1, economic crime costs society 10 to 35 times more than conventional crime.

If one looks at the socio-economic circumstances of tax criminals, they are on average the same as those of the normal population, for example as regards their housing situation. The difference that exists goes in the direction of tax criminals more frequently being business owners and normally operating in private companies with few employees. Furthermore, they also tend to have somewhat lower social status than the normal population if one looks at their level of education. Comparing socio-economic factors concerning the parents of tax criminals, the average level of education is approximately the same as for the rest of the population. However, among tax criminals there is a certain over-representation of business owner-managers among the parents.

This study establishes that an unfavourable background appears to be linked in the first instance to theft, while the link is in many cases slight between different social background factors and being tried for crimes against the Tax Crimes Act.

8.3 A strategy for preventing economic crime

In the anthology “Förebyggande metoder mot ekobrott” (“Preventive methods against economic crime”) from BRÅ, Korsell and Nilsson (2003) present a strategy for preventing economic crime, which is briefly summarised below.

The causes of crime

The basis for a preventive strategy is to have knowledge of the causes of crime and why rules are complied with. This insight is necessary in order to be able to select the right measures.

Strategy must have an impact on the causes

A flexible system of regulation and audit activity are required. The legislator should take into account firms’ assumptions for compliance with the rules. Authorities, too, should be flexible and take firms’ arguments into account. The method is based on the commitment to compliance being influenced by the trust and confidence individuals and companies have in the law and the authorities. Trust is created through legitimate, clear and not unnecessarily burdensome rules, and also by engaging in dialogue with, and providing education, information and service to those at whom the rules and audit activity are aimed. The purpose is to bring about *future compliance* rather than to *punish previous violations*. Nevertheless, sanctions are needed to prevent crime.

Legislation, audit activity, education and information should:

- strengthen the capability and create the incentive to comply with the law
- make it more difficult to commit crime
- make it more risky to commit crime
- reduce the proceeds of crime
- counteract excuses that facilitate crime

A holistic view

Crime prevention efforts must be based on a holistic view; only when the preventive work is done at different levels of society can it be effective. The preventive aspects must be taken into account in everything from planning, organisation and management

to follow-up and evaluation. It has to be done right the entire way, only then will it be possible to effectively prevent economic crime.

Knowledge and problem-oriented work

Problem-oriented work means work in which both the legislator and the authorities must as far as possible assume a knowledge of the structure and circumstances of criminality that leads to crime in order to be able to initiate the right measures.

What can the preventive actors do?

The importance of the tax authorities in preventing crime – in their relationship with the individual and with businesses – cannot be stressed enough. The preventive work of tax authorities must not be secondary to the rest of the operations. The Swedish Tax Agency's surveys show that taxpayers who have trust in the authority also consider that they have been correctly received and treated. This group also believes that the authority is doing a good job in combating non-compliance and tax evasion. This then makes them keen to comply with the law. The general conduct of the authorities therefore has an effect on criminality.

8.4 Conclusions

Research into economic crime shows that in principle it is the same factors that govern a criminal's behaviour as govern other peoples' behaviour. The existing knowledge on the causes of different behaviours can be applied more generally. Even if there are differences between "normal" cheating and tax crimes, the measures should be planned in a single context, assuming a holistic view, based on the collective knowledge we possess.

This means furthermore that Korsell's and Nilsson's strategy as described above can also be employed in the fiscal work in addition to combating economic crime.

A further conclusion is that business-owners and self-employed individuals with financial problems must be identified at an early stage. They should then be offered help and support while at the same time their everyday behaviour should be monitored. There is no certainty that audit activity will help (checking or investigating someone before tax evasion is a fact will reveal nothing and if one waits until afterwards it may be too late), although in many cases perhaps contact from the authority alone will in itself be sufficient as a preventive measure. That the authority makes contact shows that the individual is being watched while at the same time it may function as an incentive for the individual to haul himself out of his difficulties legally. A success factor for an authority is to appear to be more helpful and supportive and less threatening and demanding.

In addition to tax crimes committed within the framework of a business operation, there is economic criminality where the criminality is the actual source of income. For the criminal, tax crimes can sometimes be part of an ongoing criminality in other areas, too. Here, a successful strategy will require cooperation with the police and other authorities.

A man that studieth revenge keeps his own wounds green.

Francis Bacon

9 On punishment

In a previous chapter we described how punishment increases people's willingness to cooperate and comply with rules. But we also described how external pressures or incentives can reduce the motivation to comply with rules. In other words, punishment can be counterproductive.

How, then, should punishment be designed in order to be effective, what does the empirical evidence say as well as the research into the function and results of punishment? We shall seek to answer these questions below. First, however, we must ask ourselves the question: what is the purpose of punishment?

9.1 The purpose of punishment

The object of punishment is one of the key questions in legal philosophy. Frequent mention is made of absolute and relative punishment theories. The absolute punishment theory is very much about retribution (retributivism). One example of retributivism is Kant's ideas on punishment (Tännsjö 2003):

Juridical punishment can never be administered merely as a means of promoting another good either with regard to the criminal himself or to civil society, but must in all cases be imposed only because the individual on whom it is inflicted has committed a crime.

This, then, expresses an attitude whereby the crime must be expiated: the crime gives rise to a debt that must be paid in the same way as an account must be balanced.

Relative punishment theories are more about general prevention and individual prevention. General prevention concerns deterring citizens in general from committing crime by making punishment act as a deterrent. Individual prevention concerns preventing criminals from committing new crimes. The object is to combat criminality, not to exact retribution.

There are also other theories that involve treatment or rehabilitation, which propose that sanctions should be designed so as to adapt the criminal to living a normal life in society. Traditional punishment should then be abolished (Karlsson 1994).

The ideas concerning prevention have been criticised because of their forward-looking perspective. It is a matter of predicting what people will do in the future and determining appropriate sanctions guided by their preventive effects. This leads to uncertain judgements. Instead, the critics argue in favour of a backward-looking perspective based on the idea that punishment is dependent on past actions. The perpetrator has made himself or herself deserving of a certain punishment by committing a crime; there must be proportionality between the crime and the punishment. This is more about retribution than prevention. However, there are

combinations of the different schools of thought which concern the moralising effect of punishment, which may be called “positive general prevention”. The purpose of positive general prevention is for the punishment to send a message that the criminal behaviour is condemned by society and is unlawful and unjust, which in turn is expected to deter people from committing crime in future (Larsson 2003).

These ideas have influenced the Swedish rules for meting out punishment and choice of sanctions. Under the Swedish Penal Code (Chapter 29 section 1 BrB), the culpability of the criminality must be decisive: the culpability depends on the seriousness of the crime and the degree of reprehensibility and blameworthiness. These rules came into force in 1989. The previous rules emphasised general prevention to a greater degree (Larsson 2003).

In the area of tax crime, it is the general preventive objective that dominates. In the case of punishment determined under the Swedish Tax Crimes Act, great importance is attached to general prevention (RSV 1998:3). However, this is not entirely unproblematic. The general preventive effect requires that relatively strict punishment be imposed largely according to the nature of the crime. This can lead to a negative individual preventive effect since it does not take into account the criminal’s own personal character and the specific circumstances. Punishment which in and of itself has a general preventive effect, but which frequently has a negative individual preventive effect, cannot be successful in the long term. On the other hand, one could maintain that far-reaching consideration of individual factors when determining sanctions would result in identical crimes being punished in different ways, depending on the type of perpetrator. This might lead to the punishment having a negative preventive effect through being perceived as unjust or arbitrary.

Punishment which focuses excessively on the general preventive effect by making an example can be criticised on moral grounds, since the criminal risks being punished unreasonably hard with the aim of getting others to comply with the law. This was touched on by the head of the Ministry in the draft amendments to the Swedish Penal Code in 1989 (Prop 1987/88:120 p 37) when it was stated that the general preventive effect could in some cases be taken into account when determining culpability. It was then added that some exemplary punishment at a high level in individual cases in order to make an example was not acceptable (Larsson 2003).

It is doubtful whether the existence of a system of punishment can be based solely on whether it is preventive or not. Punishment cannot then be justified if it does not have a preventive effect. But if there is a moral debt that the perpetrator must pay through lawful retribution, the punishment can be justified even if its practical function is to prevent crime. Relative and absolute punishment theories then hang together.

This shows that the moral formational aspects previously referred to are important. It is not the strength of the punishment that produces the general preventive effect but the existence of the punishment; it is the norm internalising effect of the punishment that is significant and not the deterrent effect. This is fully in line with the arguments advanced in Chapter 3 about the importance of norms for human behaviour. It is better to comply out of self-interest (a combination of moral conviction and external incentive) than solely out of pressure (or deterrence).

9.2 Does punishment work?

Does punishment have both an individual preventive effect and a general preventive effect? The Swedish National Encyclopedia (2003) has summarised the existing research in Sweden and established that in the case of the individual preventive effect of punishment the results are clear: there are in general no demonstrably effective methods of treatment. The general preventive effect of punishment also appears to be limited. Differences in criminality between different population groups and changes over time appear in all essentials to be determined by social and historical factors and not by penal law.

It does not make encouraging reading if one views the preventive purpose of punishment as the dominant purpose. The Swedish National Encyclopedia (2003) does, however, add that research into general prevention has concentrated in the main on the deterrent effect of punishment, while the moral formative aspects of punishment are as good as unresearched.

We have established in previous chapters that punishment can work in some cases. It appears that the moral formative aspects of punishment are important or, if one does not wish to speak of morals or moral values, the reinforcing effect on the prevailing norms.

Most people are prepared to follow or comply with a (moral) norm if they can trust that other people are doing the same. This trust increases/arises if those who violate the norms are punished. The existence of punishment makes people choose to comply, not because of the deterrent effect of the punishment on the actor himself or herself, but because of the effect that the actor believes that the punishment will have on the actions of others. Most actors expect that the punishment will make other people comply and so the actors comply too. In this way, the existence of punishment contributes to the moral norm also becoming a socially descriptive norm (actually occurring behaviour).

This also means that it is very difficult for punishment to influence behaviour in the direction of anything that does not have support in a moral norm; only behaviour that is generally regarded as correct can be encouraged through the existence of punishment. People can always be coerced by means of punishment, but that does not mean that behaviour can be developed into an internalised norm.

The indirect norm-reinforcing effect of punishment is, therefore, greater than the direct deterrent effect. Studies of the law-abidingness of individuals show that most people are *disinclined* to commit crime and that they feel a moral and social duty to comply with the law if they perceive it to be legitimate. They are not influenced by variations in the threat of punishment since they are not thinking about committing crime. For the small group of individuals with a criminal lifestyle who are *inclined* to commit crime, the punishment threat does not work either. They disregard the punishment threat since it would reduce or erode their belief in the notion that crime pays. Nor are they influenced by social pressures. Individuals who have a *certain inclination* to commit crime are, however, influenced by variations in the punishment threat: even small differences in the risk of getting caught and punished are important (Korsell & Nilsson 2003).

9.2.1 How punishment is imposed is important

A mother and her 10-year-old son were sitting talking in the cinema. At first they whispered but then spoke louder and even began shouting when the film music got really loud. Finally a man came over and curtly and impolitely asked them to keep quiet. They did as they were asked. However, the boy took offence and all the way home complained about how unfair the rebuke had been. When the mother tried to explain that the man was actually right, that they should not have talked, the boy simply became even angrier at the way he had been spoken to. He felt so humiliated by the man's discourtesy that instead he defended his actions as morally right.

Sherman is talking here about his wife and son, and he believes that the son avoided feeling shame at his actions by putting the blame on the person who rebuked him. Instead, the boy expresses pride in being morally superior to the discourteous and, in his eyes, unjust man. He starts defying the prohibition on talking in the cinema and instead defends his action as morally right.

All expressions of disapproval (including legal sanctions) can provoke anger if the disapproval is conveyed in a disrespectful manner. This leads to a feeling of pride in one's actions. The behaviour becomes defiant (Sherman).

Sanctions and expressions of disapproval can be conveyed so that they are either directed at the individual ("you are a bad person") or at the act ("your action was wrong"). Sanctions are rehabilitating if they punish the act instead of the individual, and stigmatising if they punish the individual instead of the act. Rehabilitating sanctions decrease the inclination to commit crime while stigmatising punishment increases the inclination to commit crime.

This reasoning is plausible since personal stigmatisation impacts on an individual's self-respect. In order to avoid such a negative emotion, the individual puts the blame instead on the person who imposed the sanction. The individual then sees himself as a victim, which makes it right to defy the authority and instead become a rebel, which can give rise to feelings of pride. Instead of seeing oneself as a failure one sees oneself as a hero, which is naturally positive for one's self-respect. Continuing to defy the authority confirms the individual in the hero's role. And so the inclination to commit crime is increased.

If sanctions can be imposed in a way that the perpetrator perceives as legitimate, fair and respectful, they will have a positive effect. Sanctions must, therefore, be imposed so as to permit the perpetrator to retain his or her self-respect. This is perhaps not always easy to do, since there may be a natural unwillingness to treat a criminal with respect: one may need to have the temperament of an angel. In the final analysis, however, it should be a question of professionalism. Professional behaviour on the part of the authority should achieve the optimum result and the results will be better if the perpetrator's self-respect can be maintained. The sanction must be aimed at the act and not the individual.

Another important factor is the feeling of belonging or affinity that the punished individual has with society or with the person or agency effecting the punishment. The threat of a jail sentence has different effects on different people. Individuals who are

more socially integrated are more deterred by the threat of prison than those who are less socialised in society. Empirical studies of violent crime show that unemployed perpetrators of violence become more violent when arrested, while those who have employment become less violent (Sherman).

9.2.2 Do tax penalties work?

In the light of the above, it is reasonable to assume that the use of tax penalties has a norm-reinforcing effect, that is to say a general preventive effect. This is supported by taxpayers' attitudes to the tax penalty system. A questionnaire sent out to Swedish companies in 2002 showed that over 80 % believed it was right and fair that anyone who fails to file a tax return or who gives false or incorrect information should have tax penalties imposed (RSV 2002:14).

The question is whether tax penalties also have an individual preventive effect. In the year 2000, the Swedish Tax Agency surveyed attitudes among individuals who had been given tax penalties (RSV 2002:14). The survey showed that wage-earners and salary-earners who had been given penalties had less trust in the Tax Agency. They tended to agree more with the statements that they would be willing to cheat, that they employed illicit labour and that they themselves cheated. They also agreed relatively frequently with the statement that the Tax Agency would be likely to detect if anyone evaded tax and that audit activity had become more effective. The fact that the taxpayers concerned had received tax penalties did not, however, appear to have influenced their opinion as regards the consequences of tax evasion being detected. Also business taxpayers who had been given tax penalties had less trust in the Tax Agency.

Although the low level of trust may be a consequence of having had tax penalties imposed, it probably existed already, and was also a contributory cause of the taxpayers cheating. Receiving tax penalties does not at any rate appear to have increased trust in the Tax Agency.

The individual preventive effect of tax penalties has otherwise been studied very little in Sweden. The report from which the results of the questionnaire survey were taken, "Om tillämpningen av skattetillägg och skattekontrollens preventiva effekt" ("On the application of tax penalties and the preventive effect of audit activity") (RSV 2002:14) refers to a study carried out by the tax office in Jönköping in 2001, which among other things stated: "*In comparison with deductions claimed by those taxpayers who received tax penalties and those who did not, the preventive effect was greater among those who did not receive tax penalties*". The body of data studied was very small, however, and no certain conclusions can be drawn.

A laboratory study from Mexico has demonstrated the following results with regard to different levels of tax penalties (Sour 2001):

<u>Tax penalties (%)</u>	<u>Percentage with reported income (%)</u>
200	45.6
400	58.7
600	50.7

The levels of tax penalties in the experiment are very high (in Sweden it is 40 %), but the experiment shows that tax penalties only have a positive effect up to a certain level. When penalties become too high, the commitment to compliance decreases. This is probably because if the level of penalty is too high, the punishment is not perceived as fair, which provokes defiant behaviour. An excessively high penalty can, therefore, have a negative impact on both the general preventive effect and the individual preventive effect.

Webley (2001) reports that there are indications that new, tougher sanctions that were introduced in New Zealand have been counterproductive. Unfair sanctions have a negative effect.

The conclusion of all this is that, in Sweden, tax penalties have a general preventive effect, but that the individual preventive effect is probably less marked. While the general preventive effect is certainly most important, an optimal strategy must build on the ambition that sanctions should have both a general preventive effect and an individual preventive effect at the same time.

9.2.3 How should tax penalties be designed?

The question is how tax penalties can be designed so as to have both a general preventive effect and an individual preventive effect.

The system must be perceived as fair. There is nothing to indicate that the level of tax penalties is too high in Sweden, although on the other hand the situation when tax penalties are imposed can be significant. 80 % of companies take the view that a tax penalty should not be imposed if an error has been committed by mistake (RSV 2002:14).

Something that may be perceived as unfair is the fact that cooperative taxpayers are more likely to risk tax penalties than uncooperative taxpayers (RSV 2002:14). Taxpayers who fail to respond to an enquiry from the Swedish Tax Agency normally have no tax penalty levied on them since incorrect information cannot be proven.

Today, tax penalties are imposed when incorrect information is given, but the Tax Agency does not assess whether there has been wilful intent to give incorrect information, nor should it do so. 39 % of companies believe the Tax Agency is not capable of judging whether an error has been made by mistake (RSV 2002:14). A new scheme whereby the Tax Agency assesses the taxpayer's guilt is, therefore, not meeting with any great acceptance.

Since the way in which punishment is imposed has great significance (whether it is aimed at the individual or at the act), this giving of incorrect information can cause problems. If the Tax Agency imposes a penalty surcharge on a taxpayer because he or she has provided incorrect information, the taxpayer will naturally perceive this as a form of personal stigmatisation (that is to say having been singled out as a tax cheat by the authority). On the other hand, there is a demand on the part of the general public for deliberate errors or non-compliance to be punished.

A system is needed that answers to the call for justness and fairness from both the individual and from the general public, and which also creates the incentive to cooperate with the authority.

One solution may be to introduce two different levels of tax penalties. The first (lower) level could be imposed by the Tax Agency in cases of *carelessness* (and not the giving of incorrect information). Even if carelessness can be said to constitute a lesser degree of negligence than the giving of incorrect information, there may be greater acceptance for this as carelessness does not single out the individual as dishonest but merely remiss. The second (higher) level should be reserved for cases of deliberate tax evasion, fraud or repeated and systematic negligence. Malmer (2002) has put forward proposals that go in a similar direction.

A similar system to this is employed in the USA, where negligence attracts a tax penalty of 20 % and fraud attracts a tax penalty of 75 % (Lederman 2003 b).

Research also shows that punishment for minor offences has no effect on compliance, while punishment for fraud does (Feld and Frey 2001).

It is important that a system of sanctions should be well designed. Sanctions are not the only way of increasing compliance, however. Different methods need to be combined in a flexible manner. This is what Korsell & Nilsson (2003 p. 240) say in “En strategi för att förebygga ekobrott” (“A strategy for preventing economic crime”):

Sanctions are also needed in order to prevent crime. Most researchers agree, however, that more intrusive measures should only be adopted when compliance cannot be achieved with softer methods. Business taxpayers are not only profit maximisers but also want to be viewed as socially responsible (social motivation). Companies can therefore adopt ethical guidelines and introduce internal control systems in order not only to comply with the law but also to go a step further (self-regulation). What is required, therefore, is a suitable mixture of punishment and persuasion: through different types of sanctions and to stimulate the taking of own responsibility, for example self-regulation.

There should also be an option not to impose tax penalties in certain specific situations. There are tax administrations (for example in the Republic of Ireland and Cyprus) which invite taxpayers to make their own corrections prior to the commencement of a field audit, so as to permit them to avoid, or to be given lower, tax penalties. Such a possibility should be looked into further.

9.2.4 Economic sanctions or prison?

Surveys done of individuals convicted of economic crime show that sentencing them to a term of imprisonment has no preventive effect, but on the contrary leads to a number of relapses. Other surveys support the claim that a prison sentence has no preventive effect, but suggest that punishment has no effect on the risk of relapse. On the other hand, imposing financial penalties or fines on such individuals has a more positive effect for the risk of relapse. The explanation for this is that economic sanctions have a special effect on people who commit economic crime: they frequently

have assets and something to lose, compared with many of those who commit traditional crimes (Korsell and Nilsson 2003).

The use of fines creates the possibility for the individual who has been convicted of economic crime to be integrated back into society and to function once more as a law-abiding citizen. A prison sentence results in stigmatisation, which impacts on the perpetrator's self-image and how he or she is regarded by the rest of society. Prison breaks the convicted individual's links with society. Fines allow the convicted individual to remain in society and to continue to function.

Notwithstanding the above, this does not preclude the imposition of a prison sentence from sending strong signals to the business community and in that way having a preventive effect.

Other theoreticians have put forward similar ideas (James et al 2001), pointing out that prison is not only expensive but also prevents the convicted person from contributing to society with any economic activity (twofold loss) and can therefore, at an overarching level, be inferior to fines as a means of punishment. The deterrent effect of prison possibly has a positive effect on the behaviour of other people, but it is an expensive method.

Imprisonment is not something that has always existed: it is a relatively new notion. In Sweden, the prison system has its origins in a law establishing "children's houses" from 1619. These were institutions in which children who had been caught begging were detained pending their handing over as workers to craftsmen and artisans. A gradual change took place in the direction of a general prison system, even though imprisonment was rare. In 1840-41, the Swedish Riksdag (parliament) decided that prisons with cell-houses should be introduced throughout the country. However, it was not until the beginning of the 20th century that confinement in individual prison cells became the dominant form of imprisonment (Swedish National Encyclopedia 2004).

9.3 Conclusions

The following factors appear to influence the effect of punishment:

- The degree of moral justness or fairness
- How the punishment is imposed
- The type of punishment used
- The severity of the punishment is sometimes important, but most frequently not

It is interesting to note that the deterrent effect of punishment is very slight, but that the indirect effect is all the more important. Punishment works indirectly by maintaining norms and by it being perceived as deterring *other people* from committing crime. Punishment can contribute to increasing compliance with morally defensible rules. The behaviour of the person or agency imposing the punishment is of decisive importance for the efficacy of the punishment. Also the type of punishment applied must be able to be morally defended.

A further conclusion is that an authority should only utilise the possibilities for punishment that are clearly set out in the legislation, rules and regulations.

Occasionally it is suggested that authorities should “name and shame” tax evaders and criminals by publishing their names. This is a kind of punishment that affects different people differently, it cannot be appealed against and would, therefore, in all likelihood not be perceived as legitimate and morally right. Even if such a measure might have a deterrent effect on other people, it appears not to have any individual preventive effect.

The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.

Jean-Baptiste Colbert, Louis XIV's Finance Minister

10 On audit activity

What is the actual purpose of audit activity? Is it intended to deter people from tax evasion or is it meant to show how the tax system works? These and other questions such as how important the frequency of audit activity is, are treated below.

10.1 What is the purpose of audit activity?

As argued in previous chapters, one of the most important tasks of a tax audit activity is to ensure that *other people* are doing the right thing, although audit activity also has a direct deterrent effect. It should also help to increase knowledge about how the rules of the tax system work. Audit activity should have both an individual preventive effect and a general preventive effect. These are different objectives that raise different demands on the audit activity. In order for a general preventive effect to be achieved, one must take into account how serious taxpayers perceive a certain type of tax evasion to be. In order for an individual preventive effect to be achieved, one must take into account the individual's assumptions and circumstances.

To achieve a preventive effect, a combination of risk of detection and punishment is often required. A general preventive effect often presupposes that punishment is imposed. An individual preventive effect can arise without punishment being imposed (sometimes more easily if punishment is not imposed). How, then, can both objectives be achieved simultaneously?

The focus of the audit activity should in the main be governed by the general preventive effect. With regard to the choice of object for examination or audit within an area, the individual preventive effect should also influence the basis for selection. However, it is primarily *how* the audit activity is conducted that influences the individual preventive effect (according to the reasoning in previous chapters).

The conclusion is that audit activity has a different purpose depending on the context. Instead of attempting to find new objectives for audit activity, energy should be put into describing the different ways in which audit activity can be used. It will then be possible to choose the right method of approach depending on the circumstances.

10.2 Service and audit activity

We frequently hear talk of a balance between taxpayer service and audit activity which indicates that audit activity and service are viewed as competitors (for resources). If there is too much service, there will be too few resources left for audit activity, and vice versa. Another view is that service and audit activity work together. Increased service results in more correct tax returns from the start and can in that way reduce the need for audit activity. Audit activity can for its part increase taxpayers' commitment

to doing the right thing, which can increase the demand for support and help. Although these are not competing activities, they do impact on one another to a high degree.

If the same line of development is drawn out a bit further, it is evident that the boundaries between service and audit activity are being increasingly erased: to some extent service can be said to be audit activity and audit activity can be said to be service.

Examining and auditing dishonest taxpayers is a service to honest taxpayers. This is not a new idea. The Swedish Tax Agency's first Director General, Gösta Ekman, attempted to launch the expression "*Audit activity is part of the service*" (Ekman 2003).

Providing a good service to taxpayers increases trust in the Tax Agency, which demonstrably increases the commitment of taxpayers to doing the right thing. As previously mentioned, even a presence in the field in the form of educational visits has a preventive effect.

10.3 The audit activity requirement and large sums of money

The audit activity requirement means the audit activity that is required to arrive at an acceptable level of error.

The audit activity requirement is, theoretically speaking, a correct starting point for prioritisation. One should have the entirely clear picture of what needs to be done before determining any priorities. In practice, however, it is impossible to define an audit activity requirement: it is quite simply not possible to state how much audit activity will be required to prevent a certain type of error, tax evasion or fraud. As we have shown in previous chapters, the risk of detection and the size of the punishment have very little importance for how big a certain error or fraud may be. Other factors are more important. There is, therefore, no direct connection between the scope of the audit activity and the degree of tax evasion, fraud or error (even if the audit activity is of course important). For this reason alone, it is impossible to determine any audit activity requirement.

If one tries to express the audit activity requirement in the number of examinations or audits, it becomes even more obvious how impossible a task it is. It assumes namely that an examination or audit always produces the same effect as another examination or audit, that is to say that the number is significant irrespective of what is examined or audited or how it is done. Should, for example, the audit activity be focused on the most major errors, on recurrent tax evaders or perhaps on first-time tax evaders? Other questions are how the general public reacts to the tax evasion and to the audit activity. A particular strategy can produce one outcome and another strategy another outcome. Nor is it evident beforehand which strategy will give the best outcome. It is not possible, in other words, to talk about the audit activity requirement in quantitative terms.

Even if terms such as audit activity requirement and action requirement fulfil a purpose in connection with a theoretical understanding, they are of no use in the practical work. In practice one needs instead to create a particular strategy in order to tackle a

particular type of error, tax evasion or fraud. Such a strategy may contain many different measures and different types of audit activity focus. This makes it more justified to talk about an action requirement (rather than an audit activity requirement), but it is still impossible to express it only in quantitative terms.

10.4 The importance of audit frequency

Audit activity must be visible. It is of value if the examinations and audits that are conducted can be made known to others than those who are being examined or audited.

As previously described, compliance builds to a high degree on taxpayers being able to rely on the audit activity working (so as to detect the *others*, who cheat). For this reason it is important that the audit activity should be visible. However, visibility must not be seen as a term synonymous with audit frequency. The fact that audit activity exists is of crucial importance, but there is nothing that strengthens a direct link between audit frequency and the scope, extent or scale of errors, tax evasion and fraud. This does not mean that the audit frequency is meaningless; it means only that a higher audit frequency does not result automatically or self-evidently in fewer errors and less cheating. Of enormous importance is, rather, *what* is examined and audited and *how* it is done.

In the USA the audit frequency fell sharply between 1996 and 2000 in connection with extensive reforms within the IRS, which included providing improved service to taxpayers. The audit frequency for natural persons fell from 1.67 % to 0.49 % (Lederman 2003 a). The total amount of revenue raised from audits fell considerably less (from USD 37 billion to USD 33 billion). The total tax revenue collected increased during the same period. There is no indication that tax evasion increased during this period.

In Sweden, the number of field audits in 1987 was 18 887 (RSV 1998:3), but in recent years has numbered about 7000 per year; a sharp decrease, even if the audit frequency as a whole (including desk audits) has not decreased to the same extent. Even if no-one knows what the picture as regards tax evasion would had been like if the number of field audits had been higher, it is nevertheless possible to say that there has at any rate been no increase in the tax gap in the past two decades (SOU 2002:47).

A study of taxpayers in Switzerland shows that tax evasion even *increases* when the audit frequency *increases* (Feld & Frey 2004).

According to questionnaire surveys conducted by the Swedish Tax Agency (RSV 2003:2), 50 % of the general public in Sweden believe they would probably be detected by the Tax Agency if they cheated. There is, however, a difference between the real risk of detection and the perceived risk of detection.

Researchers in the USA have studied the link between the actual audit frequency and taxpayers' perception of the audit frequency. They found no link whatsoever (Andreoni et al 1998).

The question, then, is how an increase in the audit frequency can increase the extent of tax evasion if taxpayers do not know the level of the audit frequency? The equation

only works out if it is the case that examinations or audits produce a negative individual preventive effect, so that those who are subjected to them cheat more after an examination or audit than prior to it. If that is the case, one might expect increased tax evasion with increased audit activity. It is, therefore, important to ensure that the audit activity has the desired effect.

The general public do not know the real risk of detection and are in the main only able to judge it based on reports in the mass media and what other people around them report who have actually been examined or audited. Of these two methods of learning about audit activity, information from the mass media has the most impact.

Surveys from the USA have shown that taxpayers who got information from the mass media cheated less than those who got information from other people around them (Lederman 2003 b). The reason for this is thought to be that acquaintances are likely to talk about an audit only when the tax authority has failed to find any tax evasion or when the taxpayer feels himself unfairly treated. An individual who has been subjected to a (from the tax administration's point of view) successful audit can be disinclined to talk about it.

Since the general public does not know the actual audit frequency, they are also unaware of whether it increases or decreases. Even if they knew about the change it is not certain that it would influence their behaviour to any great extent. A change in the audit frequency from, for example, 3 to 4 per cent is for the tax authority a very sharp increase (+33 %), but for the general public it is still only an increase of one percentage point, which can be perceived as negligible. Nor is the most important thing how the taxpayer perceives the risk of detection for his own part, but how the taxpayer perceives the risk of detection for *other* taxpayers.

So it is the picture of audit activity as conveyed by the mass media which has the greatest potential for influencing the perceived risk of detection (both for the taxpayer himself and for others). If the general public perceives that the right area is being examined and that the authority is doing a good job, it results in a preventive effect. And so it is important to publish the results of any audit activity. Without making other comparison, one could say that this reasoning is summed up by Machiavelli when he says: "*Men in general judge more from appearances than from reality. All men have eyes, but few have the gift of penetration*".

However, a warning should be given as regards informing the public that a lot of tax evasion has been found. As pointed out in previous chapters, giving people the impression that many taxpayers are cheating can lead to even more cheating. Studies from the USA (Lederman 2003 b) indicate that reports of cheating in general decreases the commitment to compliance, but that reporting of specific and clearly defined fraud (by a certain group or individuals) does not have the same negative effect. It is also important at the same time to inform the public that the vast majority of taxpayers pay their taxes as they should.

It is a given that there must be an audit activity operation in order for there to be something to provide information about. Therefore, a certain amount of audit activity is required. However, simply because more examinations and audits are carried out

does not automatically mean that there is more to provide information about; instead, it is of crucial importance as to *what* is examined and audited and *how* it is done.

The point is that numbers alone do not have any preventive effect. Variations in audit frequency have no direct significance for the preventive effect. If many examinations or audits are conducted of the “wrong” objects and in the wrong way, it can even have a negative effect. It is therefore extremely important to ensure that the “right” object is examined or audited and that the examinations or audits are of high quality, and are carried out well and in a manner that creates trust and confidence in the tax administration. If the right things are done in the right way, a high rate of productivity in many things can also be attempted as long as they produce positive effects.

10.5 The hit-rate is extremely important

If one looks at the number of examinations or audits in relation to the number of taxpayers, one gets a picture which says that the risk of detection is low. On the other hand, if one looks at the number of examinations or audits in relation to the number of taxpayers who deliberately cheat by more than inconsiderable amounts, one gets a completely different picture of the detection risk. It is this latter picture that is the most correct for assessing the risk of detection.

In the USA, surveys by the IRS have shown that 12 % of taxpayers account for 86 % of the tax gap (Minnesota Department of Revenue 1994). Let us assume that 5 %¹⁶ of all taxpayers can be checked and that the hit-rate for these checks is 70 %. Let us assume furthermore that most of the tax evasion is found among only 12 % of taxpayers. This means that 3.5 per cent of the 12 % have been checked, which in turn means that the risk of detection, for those who cheat, is approximately 29 %. An increase of the hit-rate to 90 % results in a detection risk of over 37 %. Had the hit-rate been 70 %, it would have required an audit frequency of 6.4 % instead.

We can compare this with the customs service. Each year, Swedish Customs carries out physical checks on less than one per cent of the total flow of goods, vehicles and persons in or out of the country (Nielsen 2003). Nielsen writes:

In order to cope with the growing amount of work involved in combating crime, a large portion of innovative thinking is required. ...The customs service endeavours to be physically on the spot, preferably only when it is needed. And so it must be possible to plan when and where, for example, a customs check or intervention can take place. This requires a certain amount of advance information from businesses concerning, among other things, interesting goods consignments. With such information, boosted by comprehensive intelligence work, customs will hopefully be able to carry out checks with “surgical precision” ...

Errors that occur through carelessness, ignorance or lack of interest on the part of importers or agents must be eliminated.

¹⁶ Not the actual audit frequency. In reality there is a big difference in audit frequency between private individuals and companies.

For a period, customs field audits were used as a tool for correcting these errors after the event, but from the point of view of various aspects it was and still is not particularly effective... For all parties, it would therefore be best if the information was correct from the start.

Hit-rate should not, therefore, merely refer to the fact of errors being found; the optimal situation would be for the checks to be used in the main only for intentional errors or non-compliance. Unintentional errors are best tackled with other methods.

Such a hit-rate presupposes that an analysis is done based on both internal and external sources. Analysis permits a good risk assessment to be made. Without analysis, that is to say knowledge, the hit-rate cannot be raised.

The conclusion is that it is possible to increase the (actual) detection risk by attempting to make better selections with the aid of better analysis. However, there is nothing to prevent work being done at the same time to raise productivity. Audit activity should work with “surgical precision”. Detection risk should be measured in relation to the number of taxpayers who actually cheat, not in relation to all taxpayers. This can mean that there are gains to be had from publishing the rate of detection risk (if it really is higher than what taxpayers think it is).

10.6 Audit activity strategies

Audit activity is not about *a single* strategy or *a single* tool. Depending on how the audit activity is designed, it can fulfil a number of different purposes and form part of a number of different strategies. Below are some examples/proposals for different strategies which in many cases can be used in parallel to one another.

10.6.1 First-time tax evaders

According to the Prospect Theory (see 11.1), prevention is better than seeking to deal with the problem after the event. The theory also indicates that the longer a taxpayer has cheated, the more difficult it is to change his or her behaviour. And so there may be gains to be had in seeking to identify first-time tax evaders, both because they will be easier to influence and because they will not have cheated for very long and will not have caused a big, accumulated tax gap.

Let us assume that the way in which the behaviour of a tax evader develops over time can be illustrated by the following diagram:

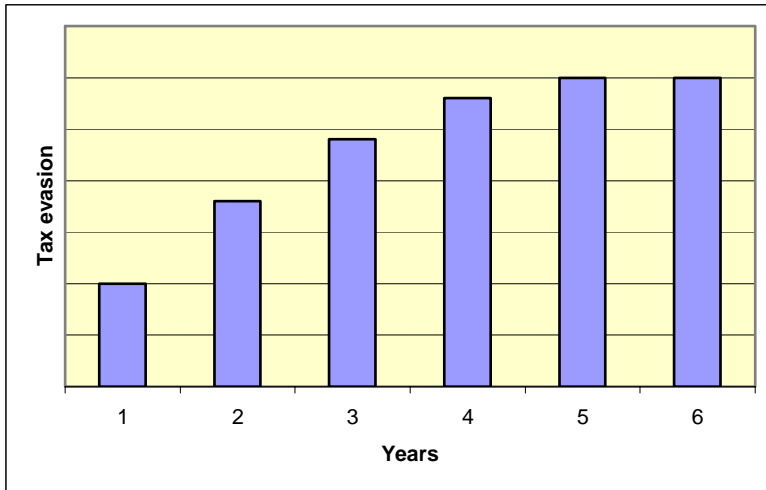


Figure 10.1 Development of a tax evader's behaviour

In the first year, the level of tax evasion is quite low, after which it increases and then levels out at a relatively high rate. The probability that an examination or audit will be successful, that is to say have a preventive effect, so that the taxpayer changes his or her behaviour and stops cheating, will increase if these measures are put in at an early stage. The taxpayer should therefore be checked in the very first year in which cheating arises (provided it has not been possible to completely prevent it happening, which is, naturally, best).

Let us assume that an examination or audit in the first year above is successful (changes the taxpayer's behaviour) in 80 % of cases and that an examination or audit in year 5 or 6 is only successful in 40 % of cases. An examination or audit in year 1 will, therefore, have a preventive effect equivalent to the sum of the values in the bars for year 2 to year 6 (and for future years) in 80 % of cases. The increase in year 1 will be modest in terms of revenue but the cheating will decrease in future. If the examination or audit is done in year 5 instead, there will be a preventive effect equivalent to the value in the bar for year 6 (and future years) in 40 % of cases. The increase is great, but the aggregate value of the cheating in year 1 up to year 4 inclusive will be lost for ever (unless the audit is made retroactive, which in some cases is possible). It will be more difficult to stop the future tax evasion, which will probably result in the cheating increasing all the time.

This shows that audit activity that is only concerned with looking for big sums of money will with great probability have a worse preventive effect, at least in terms of individual preventive effect.

There are major gains to be had by checking first-time tax evaders (if they can be found), since it can prevent new tax evaders from arising. This cannot be the only strategy, however: the big tax evaders that still exist must also be stopped.

10.6.2 Those who cheat most

Professor Leif Appelgren (2002) has done research into optimal audit activity strategies and has developed a method based on auditing the taxpayers who cheat the most. The ideas behind this are briefly as follows:

Within a homogenous group of taxpayers, that is to say a group which according to known external factors can be expected to have approximately the same actual income (for example a group of self-employed individuals within a particular trade or industry), the audit activity should be concentrated on those who report the lowest income, since it is there we can expect to find those who evade tax the most. The idea is in other words that they all have approximately the same income, which means that those who report the lowest income also cheat the most. A certain proportion of those who cheat most are checked. The audit activity strategy is made known to taxpayers.

If everyone in a group of taxpayers knows that those who cheat most will be checked (even if they are a small minority out of the total mass of taxpayers), no-one will want to be in the group that cheat most. A cheating taxpayer will then need to reflect on what other cheating taxpayers are doing. In order not to be caught, he or she must make the cheating just that bit less than the others: the taxpayer will then choose to reduce his or her cheating slightly. Since the taxpayer must assume that other cheating taxpayers think the same, it will not be enough to reduce the cheating only slightly if other taxpayers are reducing their cheating just as much. The risk of being checked is then great. The solution for the taxpayer is to reduce the cheating even more. Since the taxpayer will then also have to assume that other taxpayers are thinking along the same lines, perhaps an even greater reduction in cheating is required, and so on.

A relatively modest audit activity effort can, therefore, influence all tax evaders. Even if the cheating is not eliminated, it can be sharply reduced.

The point of departure for this theory is that those who cheat most are identifiable, which is why Appelgren takes his starting point in reported income. In reality, low income is not a good indicator for identifying tax evaders. However, this strategy works if other selection criteria are also employed (for example, money available for living expenses according to net cash calculations) as long as it is possible with reasonable certainty to find those who cheat.

This strategy works only if it can be communicated to taxpayers. If the strategy were to be employed within a clearly defined group, the taxpayers concerned could be informed about the strategy by letter.

10.6.3 Follow-up audit activity

Follow-up audit activity means checking those taxpayers again who proved to have cheated when previously checked. Doing this can help to strengthen the individual preventive effect.

A taxpayer who is detected by the audit activity may perhaps have been cheating for a long time and believes that cheating pays even if he or she is detected occasionally. The taxpayer will perhaps try to compensate for this by cheating more next time and will perhaps feel safer after having been checked inasmuch as he or she assumes that the authority is unlikely to check the same taxpayers again in the near future.

Follow-up audit activity can counteract behaviour of this kind. Let us assume that audit activity is carried out regularly in the following year on a certain proportion of taxpayers who have demonstrably cheated in a given year. The number should be

limited so that the tax gap amounts to a certain minimum sum in order for follow-up audit activity to be of interest. Other limitations can also be set.

The idea is that the follow-up audit activity need not involve many checks; yet they can still have a major preventive effect. In the case of those who are repeatedly discovered cheating by follow-up audit activity, one should commence with this type of audit activity.

In order for this strategy to be successful, it has to be known among taxpayers. This is not a problem per se. The strategy can easily be announced beforehand and the results can easily be reported afterwards.

One objection to this strategy, however, is that it rejects confidence in the individual preventive effect of audit activity. If the preventive effect works, the vast majority of taxpayers should stop cheating once they have been detected. Follow-up audit activity will then not be needed. If the individual preventive effect is poor, on the other hand, follow-up audit activity can have a significant effect on behaviour. Studies from the USA show that audit activity has only a slight effect on future behaviour. These studies demonstrated that the number of taxpayers who continued to cheat after they had been investigated fell only very slightly and that cheating otherwise remained at the same level (Andreoni et al 1998).

In terms of the general preventive effect, it seldom matters which taxpayers (within a given area) are investigated. The results are normally only reported in the form of the number of investigations, amounts and types of error or non-compliance. In the case of the individual preventive effect, it does, however, matter very much which taxpayers are investigated. Follow-up audit activity is carried out for the purpose of increasing the individual preventive effect, but it should have (at least) the same general preventive effect as other checks.

10.6.4 General preventive audit activity

Much of the general preventive effect arises from taxpayers learning about the audit activity principally via the mass media. It is important that the general public should perceive that it is the right area that is being examined and that it is being done in the right way. Audit activity should not, for example, appear to be focused on weak groups who in the main commit unintentional errors or cheat by trivial amounts. Audit activity should be aimed at the “right” tax evaders, that is to say perpetrators of different forms of serious fraud that threaten confidence in the tax system.

The general public can never have a complete picture of the audit activity, since it is not possible to tell them everything. Even if the audit activity has the “right” focus according to the above, focusing attention on an isolated audit activity can give a different picture.

In order to increase the general preventive effect, certain audit activities could therefore be carried out with the aim of drawing attention to the activity and its focus. It need not be an extensive activity, but it must involve the “right” area and the right object. Nevertheless, it is not about subjecting individual taxpayers to the light of publicity; it is about drawing attention to specific measures or activities.

The choice of area in these cases is accordingly governed by the type of attention the audit activity can achieve. At the same time, the audit activity must be conducted in such a way as to achieve an individual preventive effect and to enhance public trust and confidence in the Swedish Tax Agency.

10.7 Conclusions

Audit activity represents one type of tool together with a number of others. The entire arsenal of tools needs to be used together, since they impact on one another. This indicates that an overall strategy is required, of which audit activity forms a part.

Productivity in audit activity is important, but audit frequency should not be used as a measure of the preventive effect: the hit-rate is probably more important.

It is also difficult to view audit activity as *a single* measure or *a single* strategy. Audit activity can be used in different ways, all depending on what one wants to achieve in a certain situation. The suggested audit activity strategies mentioned here must be used together; it is not a matter of choosing one or the other (they are moreover only examples). Investigation of first-time tax evaders and of those who cheat most work well together, inasmuch as the one strategy reduces the recruitment of new tax evaders and the other reduces tax evasion from “the top down” (the worst first). The other two strategies work extremely well as reinforcing additional activity or complementary activity.

Follow-up audit activity reinforces the individual preventive effect, which will make investigation of first-time tax evaders and those who cheat most more effective. If to this one adds general preventive audit activity, one gets a further reinforced effect. The following picture describes the four different audit activity strategies.

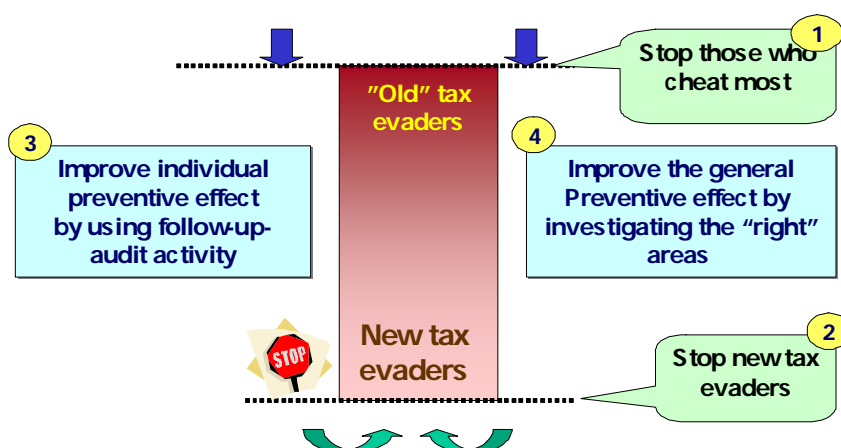


Figure 10.2 4 Four different audit activity strategies

Two of the audit activity strategies above (follow-up audit activity and investigations of those who cheat most) do not work particularly well unless the taxpayers involved know about them. This is in part a new component of how the audit activity functions. Traditionally, planned audit activity has often been kept secret so as to prevent anyone from working out what was going to be investigated. However, a clear trend in recent years has been for more and more information about investigations and audits to be

publicised (prior to them taking place). This is in line with the policy of getting everything right from the start. What is now partly new from the starting point of the proposed audit activity strategies is that strategies as such are publicised (and not only which areas are to be investigated) and that the success of the strategies lies in how well known they are.

*The theories we believe we call facts,
and the facts we disbelieve we call theories.*

Anonymous

11 Mixed theories, models and strategies

In this chapter we present a number of different theories, models and mixed strategies. The theories and models have no reciprocal connection but, taken together, they provide an excellent picture of taxpayers' behaviour and indicate potential strategies.

11.1 Prospect Theory

Since the day-to-day reality of decision makers differs from that that is assumed to apply for rational decision making, Daniel Kahneman and Amos Tversky¹⁷ developed the "Prospect Theory".

This is a descriptive theory based on extensive studies of actual behaviour. The theory can be described briefly as follows (Schaub 2001, Andréasson & Gårdlund 2002).

The following example illustrates people's apparently irrational behaviour:

In an experiment the participants were given two questions where each question contained two alternatives. One alternative had to be chosen for each question.

Question 1:

Alternative A: A gain of SEK 4000 with 80 % probability

Alternative B: A certain gain of SEK 3000

In this case Alternative A is equal to the value of a gain of SEK 3200 ($0.8 * 4000$) and is therefore the best choice from a rational point of view. 80 % of participants nevertheless chose Alternative B.

Question 2:

Alternative A: A loss of SEK 4000 with 80 % probability

Alternative B: A certain loss of SEK 3000

In this case Alternative A is equal to the value of a loss of SEK 3200 ($0.8 * 4000$) and so B is the best alternative from a rational point of view. 92 % of participants nevertheless chose Alternative A.

The experiment shows that people are unwilling to take risks (risk averse) when there is the possibility of gaining (a certain small gain is better than a big uncertain gain), but are willing to take risks when it comes to losses (an uncertain big loss is better than a small certain loss). A loss of SEK 3000 weighs heavier than a gain of SEK 3000. Gains and losses are therefore valued using different scales of values.

¹⁷ For this theory Kahneman was awarded the Nobel Prize in Economics in 2002 (Tversky died in 1996).

Apart from the scales of values being different for gains and losses, the value of marginal changes also differs. The first 1000-kronor bank note lost means less than the last one lost. In the case of gains, the reverse is true; the first 1000-kronor note gained means more than the last one gained. Therefore, when losses increase one becomes more risk tolerant and when gains increase one becomes less risk tolerant. A person who has a lot to lose can be prepared to take very great risks in order to avoid the loss. A person who already has gains is not prepared to take particularly great risks to further augment his gains.

In general, people would rather eliminate risk than reduce risk. This may be illustrated by the following very specific example. Most people would pay more to remove the only bullet from a pistol in Russian roulette than they would to remove one of the bullets from a total of four. Even though the probability of being shot is reduced by just as much in both cases, people believe that the difference between zero and one bullet is more important than the difference between three and four bullets. This effect, which is called the certainty effect, was predicted by Prospect Theory. It is worth taking risks in order to avoid certain losses. The opposite applies to gains: it is not worth taking risks that might cause the loss of an otherwise certain gain (even if an even better outcome is possible).

Another important part of Prospect Theory is that the decision maker values the gain or the loss from a particular reference point. The reference point can vary between different decision makers, but the most commonly applied reference point is the status quo, that is to say the present situation if no changes are made. Gains and losses can have completely different values depending on the choice of reference point. This is the explanation for why some people may be willing to go to an out-of-the-way store to save SEK 50 on a minor purchase but are unwilling to make the same trip to save SEK 50 on a more expensive item. It is also interesting that the decision maker's total volume of assets (for example capital) has very little significance. One might think that SEK 1000 would mean more to a poor person than a rich person, but it is the situation in the case of each individual that matters most.

If we study the behaviour of a tax-evading taxpayer, this should mean that the cheating will increase by gradual stages since the gain from the cheating will be compared with the present situation. Continuing to cheat by the same amount will mean no gain, whereas increased cheating will mean a gain. Here, one must also take into account the fact that risk tolerance reduces as gains grow bigger. Even if the taxpayer assesses the gain for the most part based on the present situation, it is presumably difficult to judge an increase in the gain without comparing it with the entire gain from the total tax evasion. In the event the tax evasion is detected, it is of course not only the increase from the previous period but the entire gain that is at stake. This should lead to risk tolerance reducing when cheating increases. The way in which cheating develops in the case of a taxpayer who is left in peace by a tax administration would then look like this:

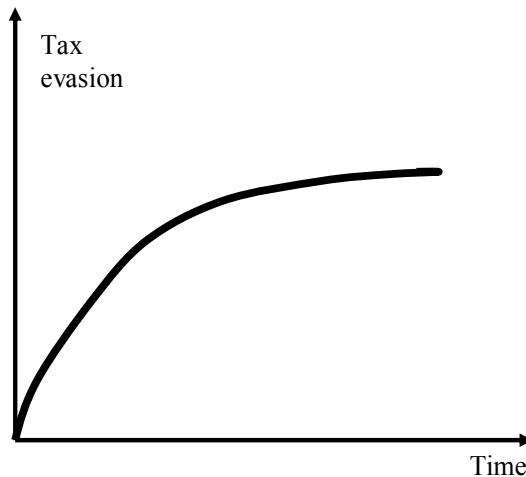


Figure 11.1 Increase in tax evasion over time

Since the tax evasion increases with time, the loss will also be greater if the individual were to stop cheating. For a tax administration this is extremely important since the longer it waits the more difficult it will be to change the taxpayer's behaviour.

Apart from the fact that the loss will grow greater with time, a tax administration must also bear in mind that a *certain loss* (=stopping cheating) is *worse* than an *uncertain major loss* (=continuing to cheat with the risk of detection and tax penalties being imposed) according to the example above.

Based on this theory, Schaub (2001) has arrived at the conclusion that it is four times as difficult to change an existing behaviour by means of threats (for example getting a tax evader to stop cheating) compared with what it requires to maintain a behaviour by means of threats (for example getting an honest taxpayer to go on being honest).

This indicates that preventive measures designed to prevent tax evasion should be more successful than measures designed to stop existing on-going tax evasion. When tax evasion exists, measures should be put in at as early a stage as possible in order to have the best effect. The longer one waits with such measures the bigger rise in revenue the audit activity can produce, but the worse the preventive effect will be.

Prospect Theory also says that decision makers tend to overestimate low probabilities and underestimate high probabilities. This could possibly be positive for a tax administration since the probability of being investigated is low and, therefore, tends to be overestimated.

As the perception of gains and losses differs, there is a difference in the behaviour of taxpayers who underpay tax and those who overpay tax. The taxpayer who is sitting and doing his income tax return and discovers that more money (than expected) needs to be paid will be more inclined to cheat than the taxpayer in the opposite situation who discovers that he will get a tax refund. The taxpayer who needs to pay more tax is willing to take risks to avoid the loss (the tax payment), while the taxpayer who will get money back is not prepared to take risks that can jeopardise his gain (the tax refund).

Judging whether there will be a gain or a loss is also based on a reference point and that is what the taxpayer expects the tax to be. If the tax owing is higher than expected, it is a loss; if the tax owing is less than expected, it is interpreted as a gain. The same applies to a refund: if it is less than expected it may be interpreted as a loss; if it is higher it is interpreted as a gain.

This is what the theory predicts, and there is evidence that it is correct. Studies in the USA have shown that individuals who underpay tax when doing their tax returns cheat more than those who are entitled to get tax back. The results are true irrespective of how much tax is to be paid or how much tax to be refunded. The level and source of income have no effect either. The Swedish Tax Agency's own surveys confirm this picture (RSV 2003, Skatteekonomiskt meddelande nr 33).

This means that a possible risk indicator for selecting taxpayers for examination is an individual who has to pay more tax when the tax returns are sent out (according to the pre-populated tax return). It also means that checking of preliminary income tax payments is successful. A business owner-manager or self-employed individual who pays no tax during the year but makes a lump sum payment in connection with filing his tax return will be more willing to take risks than an individual who has paid tax on a regular basis through the year and so avoided making large payments afterwards. Checking these preliminary income tax payments thus helps reduce the tax gap while at the same time reducing the loss of tax revenue.

In summary, the following conclusions may be drawn from the Prospect Theory:

- Preventive measures work best
- Tax evasion should be tackled as early as possible
- Small probabilities (for example audit frequency) are overestimated
- Tax owing can be used as a risk indicator
- Checking of preliminary income tax reduces the tax gap

11.2 Other behavioural theories

In addition to the Prospect Theory, there are a number of other theories concerning human behaviour, some of which are described very briefly below (Andréasson & Gårdlund 2002, Harbaugh 2002). They give increased knowledge which should facilitate greater understanding of taxpayers' behaviour.

Regret Theory

According to this theory, people have feelings of regret, which they take into account when making decisions. People predict which feelings of regret they think different decision alternatives are likely to produce and take this into account when making the decision. Let us assume that you are offered two choices: SEK 1000 in your hand or a toss-up for SEK 2000. Most people will choose SEK 1000 in order to avoid feeling regret in case they lose. They take into account the feeling of regret and it acquires a value.

Regret Theory implies that we seek wherever possible to avoid making a decision that confirms that we have made a mistake. Let us assume that you are considering selling

a share but decide not to do so. If the share then goes down, you will choose to wait and see what happens in order to have the opportunity to avenge yourself. If you don't wait and see but sell the share it confirms that your decision was a mistake, which produces feelings of regret.

Skill reputation

A decision maker takes into account when making a decision how the possible outcome may affect his or her reputation. If the odds of succeeding with something are low, it implies no risk to the individual's reputation to fail, since most people would have failed. If the odds of succeeding with something are high, it implies a risk to the individual's reputation to fail. Decision makers who are sensitive to how their reputation is perceived will tend to choose high risk projects rather than outcomes that are pretty certain.

Adaptive attitudes

An individual adapts his or her opinions and values according to the beliefs and opinions of other people with whom they feel affinity or can identify themselves with.

False consensus

This effect means that one overestimates how many people there are who share one's opinions and values.

Social comparison

We use other people as a reference for doing the right thing ourselves. Even if what we do results in loss, we are consoled by the fact that other people have also lost.

Selective perception

We expose ourselves to and take in information that confirms our actions and opinions. We wrongly interpret the information unconsciously so as to strengthen the decision we are going to make or have made. Experimental studies have also shown that we actively seek confirmation by contacting people whom we know share our views.

Persuasion effect

We are more easily persuaded by a reliable source than by a reliable argument; so the source is valued higher than the argument. If we get information from a reliable source we believe it and disregard the fact that the argument may in itself be poor. At the same time, we reject arguments that come from a source that we regard as unreliable, even if the argument can be rewarding.

11.3 The psychologist's strategem

Robert B. Cialdini is a psychologist from the USA who has specialised in areas such as compliance and influence. Below we present some of his research and its significance for tax administrations (Cialdini 1989 and 2001).

11.3.1 Consistent action

Psychologists have long observed a desire among most people to act consistently with regard to words, values, attitudes and actions: it strengthens their social image and also makes day-to-day life easier. By acting consistently, there is no need to constantly analyse information in situations that resemble previous experience. After having taken

a standpoint on a particular question, people are more willing to comply with a request that is in line with the standpoint they have taken. The standpoint has the greatest potential for influencing future behaviour if it is taken actively, openly, energetically and without external pressure. This type of standpoint taking has a tendency to “grow its own legs” through people adopting new reasons for supporting their standpoint (by confirming the standpoint, it becomes stronger). Researchers have shown that we accept responsibility for our own behaviour when we believe we have chosen it without any external pressure.

Cialdini suggests that this fact should be used to stimulate the commitment to do the right thing, by influencing taxpayers’ self-perception. Self-perception is about what one actually is as distinct from what one wants to be. Through questionnaire surveys we can find out which characteristics are important for a positive self-image and which are moreover associated with being honest about paying tax (for example honesty, fairness, willingness to help others etc). Questionnaires can also provide answers to which characteristics are found in different groups. With the help of this knowledge, we can influence these groups using tailor-made messages. If one group believes that fairness is important for their self-image and for the commitment to pay tax, the message can be conveyed that fair-minded people pay their taxes honestly.

Another measure designed to influence self-perception could be to encourage the taking of an open and public standpoint against tax evasion. For example, the Swedish Tax Agency’s campaign against illicit work contains a component which involves giving employers the opportunity to publicly take a standpoint on a website against illicit work. This is something that can be developed. Firms and individuals who publicly reject tax evasion can be invited to state this on a web page. The page is open to everyone and it is fully possible to check which firms and individuals take this standpoint. Although nothing can prevent taxpayers from cheating even though they reject tax evasion on a website, the force that Cialdini describes will work so that the standpoint agrees with the action. It is also feasible that journalists may become interested in companies that are discovered cheating, despite having publicly rejected tax evasion. If the website is properly marketed, such a measure can have a certain significance for the perception of tax evasion in general.

Yet another measure that is in line with the above is the request on Swedish income tax returns to sign one’s return “on one’s honour”. This text was removed in 2003 but there may be a point in reintroducing a similar text. The text should probably be worded differently in order not to give the impression that the authority assumes that the taxpayer is not honest. It could perhaps say “Thank you for your honest compliance”. More thought should be given to the exact wording, but the value of having a similar text should not be underestimated.

11.3.2 Trustworthy authorities

People tend to comply with instructions from trusted authorities. A famous study (conducted by Stanley Milgram in the 1960s) showed that people were willing to give lethal electric shocks to the individuals on whom the experiment was being conducted as the request came from a legitimate authority (who in this case was the leader of the experiment, that is to say a trustworthy researcher). It is symbols of authority that are most important (such as titles and dress) rather than the actual substance of the authority itself.

A tax administration is undoubtedly an authority in its particular area and it is important to live up to the requirement to be competent and fair. This results in the message from the authority being perceived as more trustworthy.

Cialdini proposes another method to increase trustworthiness and credibility. It is to present something that goes against one's own interests. This increases the ability to persuade by creating a picture of trustworthiness that makes the subsequent communication more forceful. He proposes that in connection with an investigation the authority should first of all point out an error that the taxpayer has committed to his own disadvantage: after that, it becomes easier to discuss errors that the taxpayer has committed to his own advantage.

This reasoning should not only be applicable in a specific investigative situation with reference to individual taxpayers; the same should apply at an aggregate level. This means that the Tax Agency should clearly make known and publicise how many rectifications are made to taxpayers' advantage. Such a measure would strengthen its credibility.

11.3.3 Reciprocity

One of the most basic norms governing human behaviour is reciprocity (previously described in 3.5.1). People always attempt to repay what they have received. It is, therefore, possible to give something away without it being perceived as a loss. A good stratagem is first to give something and then ask for a service in return. This method also works in negotiations: by starting with a request for something extreme that is bound to be rejected, one can follow up with a more modest request (what one was after all along). This is a concession that must be repaid and is therefore frequently accepted.

Cialdini proposes that taxpayers should be made aware of the help that exists and the availability of various service functions (online help and information, company visits, meetings for people starting up new businesses etc.). These should be "available to you should you ever need them".

The principle of reciprocity also further reinforces the benefits and advantages of rectifying returns to taxpayers' advantage as described above.

11.3.4 Social confirmation

An important principle to note is that people tend to decide how to think and act in a certain situation by studying what other people think and do in that situation. This imitative effect is very powerful. When newspapers bring a front-page report of a suicide, the number of suicides rises sharply. The effect works best under two conditions: the first is that the individual is uncertain; the second is the need to "be like other people", i.e. a tendency to act in the same way as people who are similar to ourselves or with whom we identify. The more people who believe in an idea, the more convinced an individual will be that the idea is right.

Cialdini suggests that a tax administration should publish more information to show that most taxpayers do the right thing and pay their taxes as they should. Even if there are a few who cheat, there is still the risk that some taxpayers will identify with this

minority and achieve social confirmation by cheating. A solution to this problem may be to describe the cheating taxpayers as deviant in relation to the vast majority of taxpayers: they are not “normal people” who cheat, but “other” sorts of people who are not like “you and me”.

11.3.5 Rarity and restrictions

People value possibilities and objects more if they are rare or uncommon. Rare things are frequently more valuable. When things become rarer, we also lose the possibility of choice. According to “reactance theory”, we react to the loss of choice opportunities by wanting the things even more than before. Different types of restrictions on how people should behave can trigger a desire in individuals to want to behave in the prohibited manner that did not exist prior to the introduction of the restriction.

A possible implication for a tax administration might be that a certain amount of caution should be observed when proposing new restrictions on taxpayers. It may be better to try to find measures that encourage the desired behaviour instead of measures that obstruct an undesired behaviour.

11.3.6 The why-principle

The why-principle influences behaviour: people will comply with a request more easily if they know why it is being made. The human brain loves shortcuts. Automatic reactions to some form of trigger mechanism permit us to save time, energy and mental capacity. This is the reason why it can be enough with a well-placed “because” (or “as”) to have one’s request accepted. In an experiment, an individual asked to go ahead in the queue for a photocopying machine in a library. By asking the question “*Excuse me, I have 5 pages, may I go in front?*” the result was that 60 % of those asked complied with the request. With the question “*Excuse me, I have 5 pages, may I go ahead as I have to take some copies?*” the result was that 93 % complied with the request. This was despite the fact that the second question contained no further information. The word “as” (or “because”) triggers the brain to believe that we know why, and then the autopilot accepts the request.

This may be highly significant for the way in which a tax administration should act. It is always important to explain why taxpayers should do one thing or another. It may be about how to fill in a form. By explaining why a certain box on the form should be filled in, it may increase the number of taxpayers who fill in the box (or fill it in correctly). Most business people understand the need to provide information about turnover and results, but why other information is needed is often not as clear. Brochures are often good at explaining *what* should be filled in in the various places on the form. If the brochures are supplemented with a description of *why* the information is required (preferably using the words “because” or “as”), the amount of information given by taxpayers can be expected to increase.

It is also important to explain why the authority is make inquiries about something and is requesting further information from the taxpayer. By stating “*we need this information because...*” better responses can be obtained.

At a general level, the tax authority can explain why people need to pay tax or why people should file a tax return.

11.4 Braithwaite's compliance model

Valerie Braithwaite¹⁸ (2003) has developed a tax compliance model which provides a good description of the different types of compliance (and non-compliance), likewise the effects of different measures.

If a request is put to an individual, he or she may act in accordance with the request or refrain from doing so. In the first case there is compliance and in the latter case non-compliance. This is simple. But in reality it can be difficult to decide whether a person is acting in compliance with a request. Nor is it certain that the individual understands that a request has been made or interprets the request in the manner intended. These problems become much greater when the instance making the request is an authority with the full force of the law behind it and with sanctions to hand. There is a difference between complying and doing something one is told to do under coercion that is not crystal clear. The individual perhaps has no choice but to comply, and even if there is a choice the individual has an interest in concealing the fact that he/she is not complying.

The problem is obvious from a tax perspective. Tax laws are often complicated, which means that not everyone understands what is required of them in order for them to be regarded as complying. Complex tax laws also enable taxpayers to search for loopholes or to blame failure to comply on sheer ignorance.

The model below describes compliance from the perspectives of the taxpayer and of the tax administration.

¹⁸ Head of the Centre for Tax System Integrity in the Research School of Social Sciences at the Australian National University. The Centre is a collaborative project between the Australian National University and the Australian Taxation Office.

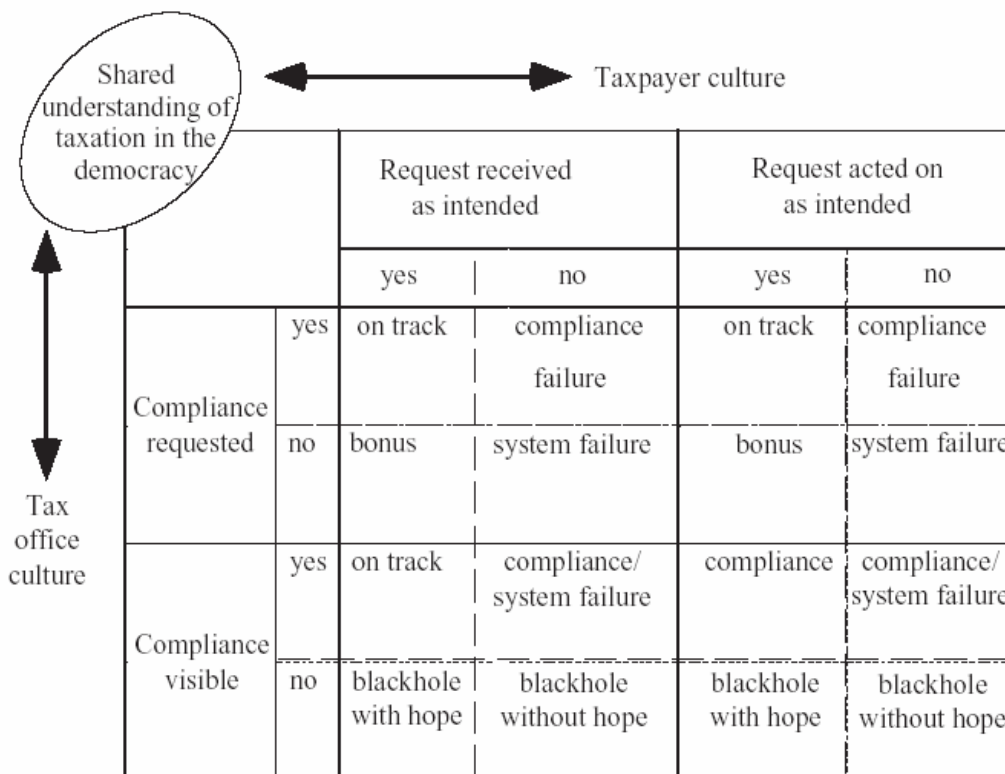


Figure 11.2 Braithwaite's compliance model.

In order for compliance to occur, the taxpayer must be aware that he or she must comply. The taxpayer must also understand how he or she must comply and that there is a commitment to doing it.

The tax administration can make a *request* in many different ways, both directly and indirectly. The most usual is perhaps to send the taxpayer a tax return form with instructions. The tax administration has an interest in knowing whether the taxpayer has complied or not. This can be achieved as far as concerns knowing whether a tax return has been filed or if a payment has been made, but it is more difficult to know whether all income has been declared. *Compliance is not always visible.*

If the taxpayer *receives no request* to comply or *interprets the request wrongly*, there is a risk that it will lead to a failure to comply, that is to say unintentional non-compliance. The taxpayer can also quite simply *refuse to comply*, that is to say intentional non-compliance.

The model contains four different questions: two referring to the tax administration (*compliance requested* or *compliance visible*) and two referring to taxpayers (*request received as intended* or *request acted on as intended*). The questions can be answered with a yes or no. These produce a total of 16 different possible outcomes (each square is a possible outcome) consisting of seven different alternatives, as follows:

- On track
- Compliance failure (mainly to do with taxpayers' behaviour)
- System failure (mainly to do with the tax administration's behaviour)

- Bonus
- Compliance
- Blackhole with hope (uncheckable but possible compliance)
- Blackhole without hope (uncheckable, non-compliance)

If one studies the 16 different outcomes, one discovers that only four contain intentional compliance (*on track* and *compliance*). The other outcomes are not the best from the tax administration's point of view.

If one studies the outcome *system failure* (four instances), one sees that it is less about audit activity and more about engaging the taxpayer. The problem can be solved by communicating the message better. When discussing the efficacy of a system, one must also take into account the fact that the authority itself may have responsibility for the non-compliance.

Compliance failure (four instances) must be treated differently to *system failure*. If the communication works but compliance failure still occurs, two different methods can be used. One method is to listen to taxpayers and by so doing try to understand the underlying reasons for compliance failure. This knowledge can be used to adjust laws, rules and procedures. One result of this may be to make it easier to comply or to make compliance failure more difficult through better audit activity and tougher punishment. The other method is to create structures that invite compliance without the taxpayer needing to make a conscious and direct decision to comply. One example of this method is to provide software or an online solution that leads the taxpayer forward through a number of questions. This does not make it impossible to cheat, but it makes it easier to comply and the thought of cheating may perhaps never occur.

The model above contains two instances of *bonus*: compliance without a direct request having been made. Strategies for increasing bonus are based on a reliance on principles and moral values or professional norms instead of laws. Principles and norms can create a frame of reference that encourages compliance. If norms are replaced by laws, it can in some cases result in less compliance since it is not then happening on moral grounds but because of a feeling of coercion.

The remaining outcomes in the model are termed *black holes* (four instances), as it is not visible to the tax administration whether there is compliance or not. In these situations, the tax administration must rely on third party sources and try to identify patterns in its databases.

Let us assume that the tax administration makes a change that enables taxpayers to better understand what is expected of them. This causes the top horizontal broken line in the model to move downwards so that the proportion of *on track* increases. The overall outcome of this is not self-evident, however. This change also results in a decrease in the proportion of *bonus*. There may be taxpayers in this category who suddenly become aware of the possibility of non-compliance. There may also be those who react negatively to a request for compliance: they feel coerced and therefore choose to offer resistance.

Similar risks are found when compliance becomes more visible (the bottom horizontal broken line moves downwards) and the proportion of *on track* increases. The

proportion of *system compliance/failure* will then also increase. In order for the tax administration to succeed, one must deal with all three parts simultaneously: increased visibility, system failure and compliance failure. If there are no possibilities for ensuring that the law is complied with when tax evasion becomes more visible, the increased visibility is of doubtful benefit.

This does not mean that changes should not be made that improve communication with taxpayers or that increase the visibility of compliance. Such changes are necessary in order for the tax system to develop. However, these changes can have complex and unexpected effects that can be difficult to understand. The important thing is not only to take into account the “*Tax office culture*” but also the “*Taxpayer culture*” or, expressed in another way, the human dimension in the game of increased compliance.

If the vertical broken lines in the model above are moved to the right, compliance increases and the proportion of non-compliance decreases. To succeed with this, more far-reaching measures are required than simply changing laws and administrative procedures. It is a matter of influencing the human dimension in the interplay between tax administration and taxpayers. This can involve listening to taxpayers, and treating them with respect and understanding. Those who take this human dimension into account will be doubly rewarded; those who listen to taxpayers gain a better understanding of why compliance failure occurs and can then also tackle the problem more easily. Taxpayers who are listened to are also more inclined to comply.

In summary, this means that changes in administrative routines and laws (the left-hand side of the model) lead to mixed results both as regards compliance and trust in the system. The impact on the human dimension (upper part of the model) has only positive results both as regards compliance and trust in the system.

Increased compliance and increased trust are mutually reinforcing. Resistance or hostility from taxpayers because of bad behaviour on the part of the tax administration results in decreased compliance and decreased trust, and in this case, too, the decrease is mutually reinforcing.

Measures aimed at increasing compliance can have a negative effect on the way in which trust in the tax administration is perceived. The art lies in finding measures that increase compliance without threatening confidence in the tax administration.

For this, a sensitivity is required to what is going on in the world around us. And this in turn demands a finely tuned intelligence system that reacts to change.

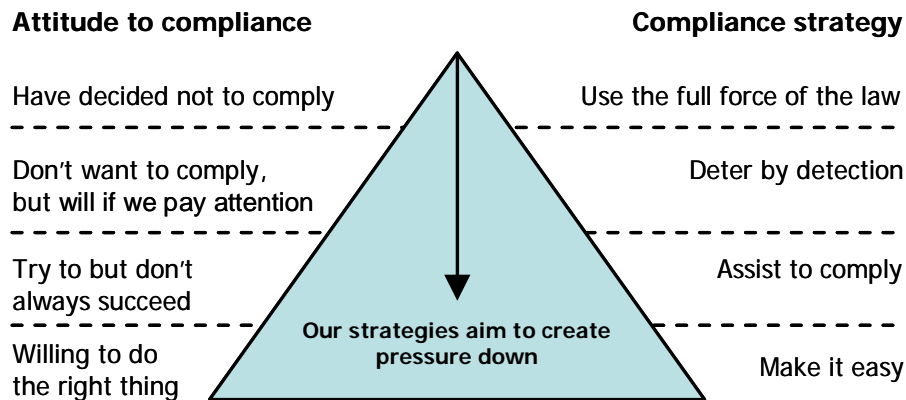
Strategies for increasing compliance should contain both general and more individual solutions, such as providing information to taxpayers about the tax system and more specific solutions for different types of taxpayers and compliance failure.

The above argument shows that the tax administration must employ a number of different strategies and different types of analyses in order to increase compliance.

11.5 The compliance pyramid

11.5.1 The pyramidal model

A model which has influenced the way in which strategies have been developed in a number of countries (including Australia, New Zealand and Great Britain) is the “compliance pyramid”. This model segments taxpayers into different groups according to their willingness and capacity to do the right thing. The tax administration then chooses different measures for different groups. The model looks like this:



The tax administration should not use tougher methods than those required in each individual case in order to get taxpayers to move down the pyramid. A point to note with this is that there should always be a possibility to adopt more forceful methods if required (gradual escalation). Unless it knows otherwise, the tax administration should assume that taxpayers are honest and willing to do the right thing. If that does not work, one should use the tools available on the next highest level of the pyramid and so on.

However, the point of departure should be that there is an understanding of what governs taxpayers' behaviour. Taxpayers can in all essentials be divided into four main categories according to their willingness and capacity to do the right thing.

- At the bottom of the pyramid are the taxpayers (the majority) who are willing to do the right thing
- On the next level are those who try but don't always succeed
- On the third level are those who try to resist compliance but who are sensitive to counter-measures (speculators)
- Highest up in the pyramid are those who have decided to cheat

There are many factors that govern taxpayers' behaviour. The pyramid is frequently linked to the “BISEP model”, which describes the different factors that influence taxpayers' behaviour.



The following factors are named in this model:

- *Business*. What the individual business looks like as regards size, profitability, ownership etc.
- *Industry*. Which trade or industry is involved and what the prevailing circumstances are.
- *Sociological*. Which social norms and attitudes apply for taxpayers and what they are influenced by (gender, age etc).
- *Economic*. What effect economic factors have, such as tax rules, inflation, special regulations, international influences etc.
- *Psychological*. What characteristics and personal values taxpayers have.

An understanding of taxpayers' behaviour must be linked to the knowledge of how different measures work. The right measures have to be used in the right context.

The model does not work, however, if taxpayers do not trust the tax administration. Trust is the basis on which the pyramid rests and which is a prerequisite for a successful strategy.

11.5.2 The theories behind the model

The model is based on two theories: *responsive regulation* and *motivational posturing* (Braithwaite & Job 2003).

Responsive regulation assumes that most people are willing to do the right thing (the majority are in the pyramid's base) and that an authority can influence them. If the rules are not morally defensible, responsive regulation cannot be employed to increase compliance.

For those taxpayers who are moving upwards in the pyramid, the authority can use persuasion, moral appeals and deterrents to get them to move down again. The following factors influence the choice of strategy:

- The measures are reasonable in that they are not more forceful than required to increase compliance. They are adapted to each taxpayer. Historic behaviour is taken into account.

- The message is “If you do not comply we will increase your costs (social and financial) but if you comply we will reduce the costs”. The measures are thus gradually intensified.
- If deterrents are to work, taxpayers must know about the sanctions that may be used and must also be convinced that the authority both can and will employ them if necessary.

This builds inter alia on research which shows that compliance and self-regulation work best if the relationship between the authority and the citizens is based on respect and open communication. If respect and procedural fairness are not observed, taxpayers will instead turn against the authority.

Motivational posturing is based inter alia on the following factors:

- The actions of the authority impact on the individual’s self-esteem. The level of threat to self-esteem is important.
- The more forceful the methods employed by the authority, the greater the threat to the individual’s self-esteem. If the methods are milder, the threat to self-esteem is reduced. This is the reason why it is desirable to employ as mild measures as possible.
- An authority can by its actions influence the behaviour and attitudes of the individual. This impacts on the individual’s motivation to comply. If the authority threatens the individual’s self-esteem, he or she will move upwards in the pyramid.
- Compliance is influenced by how taxpayers perceive the authority’s behaviour. Compliance is high if taxpayers perceive it as morally right to pay taxes and if the tax administration’s behaviour is fair and decent.
- Refusal to comply is driven by a desire to be rich, a distancing from honest taxpayers, and a willingness to ally oneself with those who know all the tax evasion tricks. Those who refuse to comply have no trust in the tax administration and the probability that they will acquire such trust in the future is low.

11.6 Preventing error, non-compliance and fraud

Lars Korsell and Mikael Nilsson have described in their book “Att förebygga fel och fusk” (“Preventing error, non-compliance and fraud”) (2003) various methods and angles of approach that tax authorities can use. Below are summarised some thoughts and suggestions on this topic.

In their introduction (p 16), they describe the purpose of the book as follows:

It is not principally about increasing society’s tax revenues or reducing the costs to society by reducing error, non-compliance and fraud. Instead, it is about reducing error, non-compliance and fraud in order to maintain the legality and legitimacy of the system. Audit activity issues and a more non-compliance and fraud-proof legislation should therefore have greater emphasis in the administrative work. At the same time, regulation and audit activity should not go too far and be perceived as unnecessary and unfair, resulting in

a demoralising effect both for the audit functions themselves and for those who are subjected to audit activities. The challenge is to find a reasonable balance.

Preventive measures must adopt a problem-oriented approach where the base is made up of knowledge about non-compliance and fraud. It is important to:

- Identify the problems
- Analyse the causes
- Develop measures based on this knowledge
- Follow up and evaluate the chosen measures

Korsell and Nilsson take the view that (p 23) “*A disadvantage with the way in which the authorities work today is that they are too governed by events and for that reason operations are too focused on demonstrating and correcting errors that happen to be detected.*”

It is not possible, in other words, to create effective measures to counter error, non-compliance and fraud if one knows nothing about the causes.

Measures should be based on inter alia the following knowledge concerning motivation for why an individual complies with or violates the rules:

- To prevent tax evasion it is more effective to increase the risk of detection than to rely on the threat of punishment
- Legislation and audit activities that are perceived as reasonable and fair increase law-abidingness among taxpayers
- If other people break the law, individuals are less inclined to comply with the law themselves
- Informal sanctions from family, friends and colleagues have a greater preventive effect than formal punishment

Korsell and Nilsson’s conclusion is the following (p 42):

An exercise of authority based on mutual understanding that is supported by the possibility of employing strict sanctions is more likely to increase compliance than a strict legalistic exercise of authority based on the threat of sanctions and confrontation.

Below are provided a few examples of the different measures that Korsell and Nilsson propose.

Don’t always aim the rules at the problem but at those who can prevent the problem

To prevent tax evasion or fraud, it is possible to get the help of the people around a potential perpetrator. This involves engaging the assistance of a third party, someone outside a supervisory authority and the supervised. These individuals may be

“gatekeepers”, for example boards of directors, external auditors, environmental auditors, ethics committees etc.

Typical for gatekeepers is that they have little to lose if a crime is detected compared with the people in the organisation who have committed the crime. On the other hand, gatekeepers care about sanctions. For example, in Sweden accountants who fail to report a suspected crime can be reported in turn to the Supervisory Board of Public Accountants.

Logo types and other symbolic rewards

Using various symbolic rewards, one can attempt to induce businesses to carry out measures to prevent non-compliance and fraud. To win this distinction businesses must satisfy a given number of criteria.

Increase the moral costs

By stating that a certain action is criminal, most people feel great internal resistance to committing such an act themselves. It is perceived as stigmatising to be associated with a criminal act.

Demonstrate strength against the capital

Research shows that measures which impact on a firm’s profitability and reputation are frequently more effective than punitive measures.

Signature “on one’s honour”

Income tax return forms should be supplemented with a request that the taxpayer sign the form on his or her honour in order to stress the requirement to provide correct information and to encourage the person signing the form to reflect on his or her obligations.

Strengthen the authority’s legitimacy

Professional treatment of taxpayers on the part of the authorities prevents non-compliance and fraud.

Increase ethical behaviour in the public sector

Surveys show that ethically dubious behaviour among people in positions of power influences the willingness to cheat.

11.7 The letter-writing authority

In the chapter on norms (see Chapter 3), it was noted that norms and behaviour could be influenced by informing taxpayers by letter about other people’s norms and behaviour. Compliance can thus be influenced by writing letters to taxpayers. Below are further examples of how a tax administration can influence compliance quite simply by writing letters to taxpayers.

Great Britain

An experiment was carried out in Great Britain (OECD 2004, Wright 2003) involving small businesses. Sole proprietors with an annual income of less than £15 000 need not specify their expenses. The experiment tested five different types of letter that were sent out before tax returns were due to be filed. The target group consisted of sole

proprietors who filed their own tax returns and whose expenses exceeded 50 % of their turnover. Six groups were created, one for each letter, and a control group. The following types of letters and groups were employed:

1. "We can give you help and support"
2. "Correct payment of tax means more money for hospitals, schools etc"
3. A warning: "We are increasing the number of investigations, and your tax return may be chosen"
4. The same as letter number 3 but adding "You may incur financial penalties"
5. "Your tax return has already been selected for audit"

Letters 3, 4 and 5 gave a significant increase in reported income and profit. 10 % of the tax returns were checked in groups 3 and 4. Letter number 5 gave the best result (everyone in that group was checked) in terms of reported profit, but in terms of expenses letter number 4 gave the best result.

USA

An experiment was conducted in Minnesota (Minnesota Department of Revenue 1994) using the following letter strategy.

An experimental group was selected as well as a control group. The group that received the letter was divided into two categories: one category representing average taxpayers (called the low risk group) and one that was judged as representing a higher risk (high risk group). The high risk group consisted primarily of self-employed persons. In total, the group comprised approximately 1 600 taxpayers.

The group received a letter prior to the filing date for tax returns, which contained the following information:

- That they had been selected randomly for examination
- That they would be contacted if any discrepancies were found in their tax returns
- That if any irregularities were found, previous years' returns would also be examined

The letter attracted the attention of the press and many people were indignant at having been threatened with having their tax returns examined.

In addition to the group being divided into low and high risk respectively, they were also divided up according to income level (low, middle and high).

The results showed that reported income and tax payments increased among low and middle income taxpayers in both the low and high risk categories. The biggest increase was in the middle income and high risk category. In the high risk group there were both increases and reductions in paid tax and the net change was marginal.

In the low and middle income groups, tax payments increased by 6 %. In the high risk category, tax payments increased by 10 %.

The biggest effect was in the group that had had their tax returns changed (lowered) to the taxpayers' advantage at the previous assessment. Among those who had previously been given tax penalties, the letter had a negative effect.

Sweden

In connection with the 2001 tax assessment, the tax authority in Gävle sent out an information letter to a group of self-employed persons who were required to reverse tax allocation reserves¹⁹ for taxation. The letter was sent out prior to the date for filing tax returns. The letter was personal and each recipient was told how large an amount had to be reversed. A control group was employed which received no information. Both groups were then checked and it was measured how many taxpayers had reversed the tax allocation reserve correctly.

The diagram below shows the results.

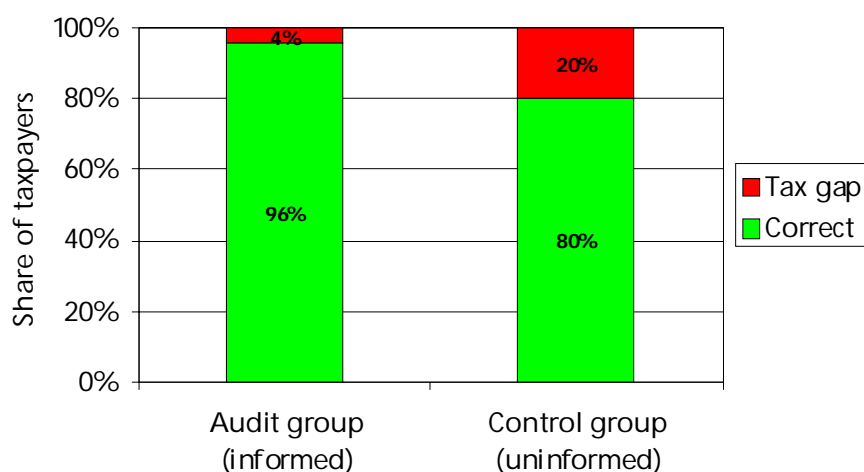


Figure 11.3 Effect of information letter

The group of taxpayers who received a personal letter did the right thing to a considerably greater degree than the others. The control group did not receive any personal letter, but all self-employed taxpayers were sent information in brochures, etc which stated that the tax allocation reserves had to be reversed.

11.7.1 Conclusions

The example above shows that the letter-writing authority can be successful. Writing a letter can be a cheap method that produces good results. However, it is important how the letter is worded and for the right type of letter to be sent to the right target group. Different letters have different purposes and different contents. The following types of letter can be identified:

- Letters intended to influence norms and attitudes, containing information about other people's behaviours and norms

¹⁹ Tax allocation reserves are appropriations aimed at equalising reported net (taxable) profit. In order to equalise the tax burden, it is possible to set aside some of the profit to a tax allocation reserve. This can then be reversed at any time but no later than six years after the reserve was made. The reserve made at the 1995 tax assessment would have to be reversed for taxation at the 2001 assessment.

- Letters announcing audit activity of different kinds or providing information about audit activity
- Letters providing general information or information about specific tax issues

Letters with personal information probably have a greater effect than letters containing general information. Letter-writing should be included as a normal part of the mix of different measures taken for priority areas. This is yet another tool that cannot be classified easily as either service or audit activity.

*Attaining one hundred victories in one hundred battles is not the pinnacle of excellence.
Subjugating the enemy's army without fighting is the true pinnacle of excellence.*

Sun Tzu

12 On strategies and strategic thinking

This report contains a quantity of facts and suggestions for numerous measures and strategies. How, then, should this knowledge and these suggestions be used to achieve optimum results? It can be of value in this context to briefly consider what creates good strategies and what strategic thinking actually involves. This can serve as a tool for more easily combining different measures and achieving optimum results. A good beginning is to look at what the reference books have to say.

12.1 Different views of strategies

Activity structures

According to the Swedish National Encyclopedia, strategies are overarching, general activity structures that stretch over a long time horizon. The content of the strategy is determined by the organisation's relationship with its surroundings. Since the 1970s, the term strategic process has sometime been used, according to which strategies are regarded as evolving rather than planned.

This gives a picture of what strategies are, but it does not facilitate the thought process. Other ways of looking at strategies are also needed.

Strategies are a part of the totality

Another way of describing strategies is to start from the following model, which says that strategies are a part of the totality (Gill 2003):

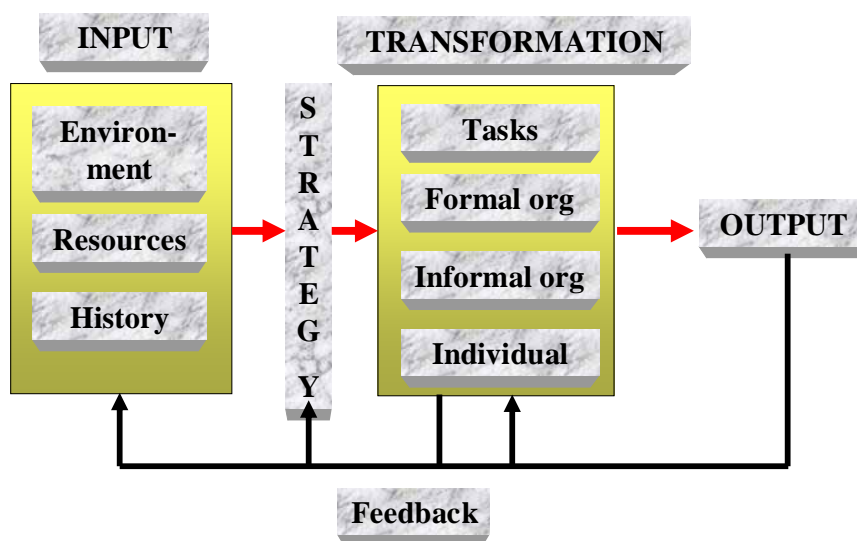


Figure 12.1 Gill's strategy model

The potential for the tax administration to work effectively depends on a number of factors. There are factors in the surrounding world that have to be taken into account (both formal and informal), and the available resources also naturally influence what can be done. Also the administration's history has an impact, in terms of previous experience of successful and unsuccessful activities, and the development of norms and values. Strategies are intended to achieve objectives. In order to do this, what is termed input is transformed through a process that is influenced by four components. Different activities are carried out that are influenced by the rules and regulations (formal) but also by the prevailing culture (informal). The activities are carried out by individuals, and their number, excellence, engagement and values influence the process. All this results in an output which in turn gives feedback to previous steps in the process.

The point about this model is that it demonstrates that the success of the tax administration depends on the agreement between the different parts of the model. The greatest success is achieved when strategies are adapted both to the surrounding world, the resources and the history, and also adapted to output. The transformation process must fit the strategies and the four different components of the transformation process must agree among themselves. When there is a lack of agreement in any of these respects, the success of the organisation will be less.

A holistic view is good, but strategies can also be illuminated from other angles.

Complex systems

As previously noted, there are many complex factors that govern taxpayers' behaviour. Influencing these behaviours is thus also an extremely complicated affair. A tax administration works in a complex and constantly changing environment. These are complex systems that are characterised by the following (Jervis 2003):

- *The result cannot be predicted from a single action.* The effect of a measure frequently depends on the effect of another. Combinations of measures create effects other than those of a single measure alone.
- *Strategies depend on others' strategies.* The complexity increases if one considers the connection between different actors' strategies. One actor may react to the other's strategy and change his own. Actors may also try to predict their opponents' strategy and adapt their own accordingly. This interaction is important to bear in mind, otherwise it is easy to find fault. One example can be taken from the Vietnam War, when the USA stopped patrolling part of the enemy's supply line after its use decreased. This simply resulted in the enemy increasing the use of these same lines.
- *Measures change the surrounding world.* Initial measures and results can change subsequent results with a dynamic that changes over time. This cannot simply be explained with the help of cause and effect. Since the measures change the environment in which one operates, a measure, identical to a previous measure, will not produce exactly the same results again. This was something that Hitler failed to grasp in 1939. He had experience from the meeting in Munich which showed that the Allies were compliant (Austria was ceded), and therefore believed that the Allies would be equally compliant when

it came to Poland. However, the Allies had changed their behaviour because of Hitler's behaviour and the Second World War was a fact. This is a common mistake; basing one's ideas on the observable world and then planning one's actions based on that picture. One fails to realise that one's own actions impact on the surrounding world and create changed conditions for the planned actions. The following example illustrates this:

During the 1930s, Japan was worried about its own national security and about access to commodities from abroad. In order to prevent this problem, Japan invaded Manchuria, declared war on China and invaded Indochina. Each action created resistance that made the next action necessary. The measures led finally to the USA's oil embargo. This caused Japan to attack Pearl Harbour and the USA with the results we all know. Japan's original desire to increase its security resulted in exactly the situation it wanted to avoid: a war with the West.

Complex systems are frequently defined based on the assumption that there are a large number of similar but independent actors who interact and who therefore also change the environment in which they operate (Valle 2000).

Management literature has increasingly begun studying complex systems in order to learn how to handle a complicated world (Lissack 1996). The starting point is that the world around us is so complex that it is impossible to make exact predictions or to understand all the details. However, it is possible to gain an overall picture and an understanding by studying patterns.

If changes in the world around us cannot be predicted, detailed long-term planning is meaningless. This makes demands of strategies and the way in which strategies are executed. Strategies are about supervising the actions of an organisation so as to ensure that the desired objectives are fulfilled. This can only be done by constant monitoring and evaluation in order to detect any changes and to change planned measures in response to those changes.

This is in line with Dwight D Eisenhower's famous expression: "Plans are nothing, but planning is everything". A plan becomes obsolete in the very moment it is finished: planning is something that must go on continually.

From a management perspective (Lissack 1996), the important thing is to create adaptable organisations with flexible structures that optimise the opportunities for continual learning.

The fascinating trinity

The famous military strategist Carl von Clausewitz (1780-1831) had already assumed this similarity with complex systems since his ideas went along the same lines. He made use of a metaphor based on a known scientific fact. If one sets a pendulum (of iron) swinging between three magnets, it will begin moving in a non-linear manner, that is to say chaotically, and will never repeat the same pattern of movement (this is known as "the fascinating trinity").

In the metaphor the three magnets represent three different types of forces: irrational forces (emotions), non-rational forces (the influence of chance without human intervention) and rational forces (rational calculation). The pendulum represents theories or strategies. Strategies are never influenced by one force alone but by the total interaction between all the forces, which is also constantly changing. A strategy that denies or reduces the importance of any of these forces will fail.

Instead of forces, the magnets are sometimes likened to the people, the army and the state. If the army is replaced by the tax administration, however, the metaphor also works.

12.2 Conclusions

At an overarching level, strategy is the art of planning and carrying out activities so that they result in the fulfilment of the desired objective. The remarks above also indicate that strategies and strategic thinking consist of the following elements:

- *Knowledge*. The basis for good decision making is always knowledge about what the decision is about. Without knowledge there can be no good decision.
- *Holistic view*. It is important to see the totality and to be aware that each part affects the totality, and likewise that the totality affects every part.
- *Awareness of interactivity*. A measure may impact on the actions of other actors, which may make the measure meaningless or wrong. The measure may also impact on the surrounding environment, which changes the assumptions for carrying out the measure.
- *Long-term thinking*. It is important to think several moves ahead all the time and to be prepared for what may happen. Even if details cannot be predicted, patterns can be detected.
- *Flexibility*. Yesterday's success is tomorrow's failure. The changing world around us makes demands on flexibility and our ability to make rapid changes to planned measures. This requires a good knowledge of the surrounding world and of the effects measures have.

*Never doubt that a small group of thoughtful,
committed citizens can change the world;
indeed, it is the only thing that ever has.*

Margaret Mead

13 Overall conclusions

It is extremely important for a tax administration to understand the huge impact norms and moral values have on behaviour. To achieve voluntary compliance, one cannot rely on deterrent methods like audit activities and punishment. But this does not mean that audit activities and punishment should be of less value; on the contrary, they are of vital importance. Their importance does not lie in their deterrent function, however, but in the fact that they can be used to strengthen and support existing norms.

People do what other people do. Audit activity and punishment can help convince people that other people are complying with rules. It is norms that govern behaviour, but it is audit activity and punishment that ensure that the norms are upheld.

Nevertheless, both audit activity and punishment are a two-edged sword. Handled in the right way, they can do a great deal to help bring about voluntary compliance; but handled in the wrong way they may result in increased tax evasion by reducing taxpayers' personal convictions or by provoking reactions of defiance.

Moral values, in the sense of biologically inherited and socially learned norms, are underestimated as an explanatory component in behaviour. And so moral values are also underestimated as regards their effect in influencing behaviour.

Behaviour can be influenced by means of campaigns but also by everything an authority does in its day-to-day operations. The way in which taxpayers are received and treated, attitudes, brochures, forms, the kind of things that are subjected to audit activities, processing times and a whole lot of other things influence taxpayers' behaviour and thus also the tax gap. It also means that everyone who works for the Swedish Tax Agency can have an impact on the tax gap.

The importance of information, education and service should not be underestimated. Making things easier for taxpayers by providing good service and simple rules helps not only to keep taxpayers honest but can also help make the dishonest honest. Apart from the risk of detection, tax evasion results in costs of concealment of what is going on, of double accounting, and of the strain of looking over one's shoulder all the time in case the authority is standing there wondering what one is up to. If cheating means more complications, trouble and inconvenience than doing the right thing, taxpayers' behaviour can be influenced. It should be easy to do the right thing.

Information, education and service can, in addition to making it easier for taxpayers who are willing to do the right thing, increase public trust and confidence in the tax administration, decrease the trouble involved in tax evasion and decrease the value of excusing tax evasion. Taken together, these things can get more taxpayers to do the right thing.

Most tax administrations make ambitious and frenetic efforts to try to identify the tax evaders. This is a necessary and legitimate job, but there is a risk that the entire focus lands on the tax evaders, and that it becomes the starting point for everything that the tax administration does. It is then easy to become suspicious of taxpayers and to end up in a situation where there is an automatic assumption that everyone is cheating or trying to cheat. One forgets that tax evaders are in the minority.

A totally different outlook occurs if one puts honest taxpayers at the centre of things. Honest taxpayers should be the starting point for everything the tax administration does, but without forgetting the tax evaders. It is the honest taxpayers who require the tax administration to take measures to search out and to combat tax evaders; the work is carried out on their behalf. With this approach, the operation gets a completely different focus based on the willingness and the commitment to cooperate with taxpayers.

A problem-oriented working method is tempting: this involves focusing on solving a particular problem or problems instead of asking oneself “what should we investigate this year?”. The need for knowledge then also becomes very clear. In order to solve a problem, one must understand the scale and the nature of the problem. Let us assume that 10 % of taxpayers make an error in risk area A and that the error is largely intentional; let us assume furthermore that 80 % of taxpayers make an error in risk area B and that the error is largely unintentional. Completely different strategies are required for these two risk areas. Knowledge about the scale and the nature of the problem is absolutely essential in order to choose the right measures.

Traditionally, the tools utilised by the tax administration have on the whole been described as audit activity and service. In addition, system changes have also been used, such as changes in legislation, the introduction of statements of income and similar, although these are matters over which the tax administration itself has no control.

A clear conclusion is that a tax administration has considerably more strings to its bow. However, knowledge and skill is required if the playing is to give rise to harmonious tones instead of a miserable cacophony. It is not enough for tools to exist and to be available; they must also be used in the right way and in the right instance. Audit activity should not be viewed as *a single* tool but audit activity can be used in different ways to achieve different purposes. Influencing norms and attitudes is neither audit activity nor service but one of the most important tasks for a tax administration. Such work can also be integrated with other work by ensuring that brochures, forms, decisions and similar are framed in the light of their norm-influencing function. Writing letters to taxpayers with information about rules or about audit activity is also an activity that can be substantially developed.

At an overarching level, a general strategy might look as follows:

- The foundation must always be *knowledge*. A little knowledge can be misleading but sufficient knowledge can provide insight that enables a number of situations to be understood. Knowledge is needed of the causes of error, non-compliance and behaviours, and of the effects had by different measures.

- Strategy should involve solving certain identified *problems*. Strategy should not be tied to one particular tool or tools, but the objective must be for the problem to be solved with the aid of the most appropriate tool or tools.
- An important starting point is that *norms and moral values* are decisive for behaviour, and that audit activity and punishment can maintain norms but only act as a deterrent to a limited extent. The cause of behaviour is what other people do. The Swedish Tax Agency should therefore ensure that *everybody else is doing the right thing and fulfilling their obligations as taxpayers*.
- A prerequisite for this to succeed is that there is high public *trust and confidence* in the Swedish Tax Agency.

Maintaining a holistic view is important, but it is also important to see the different parts of the totality and how they hang together.

A strategy will not be successful if it cannot be carried out as intended. Objectives and strategies govern the behaviour of an organisation to only a small degree. What is most important is how the organisation and employees are followed up and assessed.

One interesting conclusion from the chapter about audit activity is that the level of audit frequency has no connection with the general preventive effect. This does not mean that audit frequency is uninteresting or that it should not be measured: it means that the general preventive effect must be assessed using other factors such as trust and the way in which taxpayers are received and treated.

It is important to focus not only on goals and objectives that can be easily measured. If that happens, there is a risk that we will allow the debate to be about short-term, measurable, quantitative aspects instead of discussing issues involving ethical attitudes, norms and trust. We must also permit ourselves to employ non-measurable values: it is these that really mean something.

References

- Allingham, M., G., Sandmo, A. 1972, *Income Tax Evasion: A Theoretical Analysis*. University of Pennsylvania, Philadelphia, USA and The Norwegian School of Economics and Business Administration, Bergen, Norway.
- Alm, J., McClelland, G. H., Schulze, W. D. 1992, Why do people pay taxes? *Journal of Public Economics* 48, North-Holland.
- Andersson, P. 2001, Betydelsen av psykologiska och sociala faktorer för ekonomiskt beteende (The importance of psychological and social factors for economic behaviour). *Ekonomisk Debatt*, Vol 29, No 8.
- Andréasson, D., Gårdlund, A. 2002, *Fondsparares beteende (Unit trust holders' behaviour)*. Förtägssekonomiska institutionen, Stockholms Universitet.
- Andreoni, J., Erard, B., Feinstein, J. 1998, Tax Compliance. *Journal of Economic Literature*, Vol XXXVI, June 1998, pp 818-860.
- Appelgren, L. 2002, Material from a lecture at Linköping International Conference on Economic Crime on "Optimum Use of Limited Audit Resources", 25-27 August, University of Linköping.
- Braithwaite, J. 2003, Large Business and the Compliance Model. From: *Taxing Democracy – Understanding Tax Avoidance and Evasion*, edited by V. Braithwaite. Ashgate, England.
- Braithwaite, V. 2003, Tax system integrity and compliance: The democratic management of the tax system. From: *Taxing Democracy – Understanding Tax Avoidance and Evasion*, edited by V. Braithwaite. Ashgate, England.
- Braithwaite, V., Schneider, F., Reinhart, M., Murphy, K. 2003, Charting the Shoals of the Cash Economy. From: *Taxing Democracy – Understanding Tax Avoidance and Evasion*, edited by V. Braithwaite. Ashgate, England.
- Braithwaite, V., Job, J., 2003, The Theoretical Base for The ATO Compliance Model. Centre for Tax System Integrity, The Australian National University. Research Note 5.
- BRÅ Rapport 2003:1, Förebygga ekobrott – Behov och metoder (Preventing economic crime – Needs and methods). Brottsförebyggande Rådet, Stockholm.
- BRÅ, 2003, Attityder till ekonomisk brottslighet 1988 och 2001 – Resultat av en enkätundersökning (Attitudes to economic criminality 1988 and 2001 – Results of a questionnaire survey), Brottsförebyggande Rådet, Stockholm.
- BRÅ, 2003:3, Skattefifflare och tjuvar – En studie av sociala förhållanden och brottsbelastning hos två grupper av lagförda gärningsmän (Tax dodgers and thieves – A study of social conditions and criminal handicap in two groups of convicted offenders). Brottsförebyggande Rådet, Stockholm.

Bruce, S. 1999, *Sociology: A Very Short Introduction*. Oxford University Press Inc. New York.

Cialdini, R. B., 1989, *Social Motivations to Comply: Norms, Values, and Principles. Taxpayer Compliance, Vol 2*, Edited by Roth, J. A., Scholz, J. T. University of Pennsylvania.

Cialdini, R. B. 1996, *Activating and Aligning Two Kinds of Norms in Persuasive Communications. Journal of Interpretation Research, Vol 1, No 1.*
<http://www.journalofinterpretationresearch.org/issues/v1n1/article1.html>

Cialdini, R. B. 2001, *Influence Science and Practice*, 4th ed., Allyn & Bacon, Boston.

Cosmides, L., Tooby, J. *Evolutionary Psychology: A Primer*. Center for Evolutionary Psychology, University of California.
<http://www.psych.ucsb.edu/research/cep/primer.html>

Damasio, A., R., 2003, *Descartes Misstag (Descartes' Mistake)*. Bokförlaget Natur och Kultur, Stockholm.

DN, 2002, *Samarbete kräver straff (Cooperation demands punishment)*. Dagens Nyheter, Vetenskapsredaktionen, 9 February.

DN, 2003, *Apor gör uppror mot orättvisor (Monkeys revolt against unfairness)*. Dagens Nyheter, Vetenskapsredaktionen, 28 September.

DN, 2004, *Laglydig för att slippa skämmas (Law-abiding to avoid shame)*. Dagens Nyheter, Insidanredaktionen, 12 January.

Edlund, J., Åberg, R. 2001, *Social Norms and Tax Compliance? Paper from conference in Stockholm, "International Mobility of Tax Bases"*.

Ekman, G. 2003, *Några drag i den svenska skatteförvaltningens utveckling (Some features of the development of the Swedish tax administration)*. From "Deklarationen 100 år och andra tillbakablickar", Riksskatteverket (Swedish Tax Agency), Stockholm.

Fehr, E., Gächter S. 1999, *Cooperation and Punishment in Public Goods Experiments*. Institute for Empirical Research in Economics, University of Zurich.

Feld, L. P., Frey, B. S., 2004, *Illegal, Immoral, Fattening or What? How Deterrence and Responsive Regulation shape Tax Morale*. Philipps University of Marburg, University of Zurich.

Feld, L., P., Frey, B., S. 2002, *Deterrence and Tax Morale: How Tax Administrations and Taxpayers Interact*. University of Zurich. <http://www.wiwi.uni-marburg.de/Lehrstuehle/VWL/FiWi/f2/Forschung/Arbeitspapiere/TaxOECD.pdf>

Felkins, L. 1999, *A Rational Justification for Ethical Behaviour*.
<http://www.magnolia.net/~leonf/common/moral3.html>

- Frey, B. S., Jegen, R. 2000, Motivation Crowding Theory: A Survey of Empirical Evidence. Institute for Empirical Research in Economics, University of Zurich. Working Paper No 49.
- Gill, J. B. S. 2003, The Nuts and Bolts of Revenue Administration Reform. The World Bank. <http://www1.worldbank.org/publicsector/tax/NutsBolts.pdf>
- Harbaugh, R. 2002, Skill Reputation, Prospect Theory and Regret Theory. Claremont Colleges Working Paper No 2002-03. Social Science Research Network Electronic Library. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=311409
- IFS, 2003, Tillväxt kräver legalt kapital (Growth demands legitimate finance). Unpublished. Internationella företagarföreningen i Sverige (Association of International Entrepreneurs in Sweden).
- James, S., Hasseldine, J., Hite, P. & Toumi M. 2001, Developing a Tax Compliance Strategy for Revenue Services. International Bureau of Fiscal Documentation, Bulletin April 2001 pp 158-164.
- Jervis, R. 2003, Complex Systems: The Role of Interactions. <http://www.ndu.edu/inss/books/books%20-%201998/Complexity,%20Global%20Politics%20and%20Nat'l%20Sec%20-%20Sept%2008/ch03.html>
- Kagan, R. 1989, On the Visibility of Income Tax Law Violations. Taxpayer Compliance, Vol 2, Edited by Roth, J. A., Scholz, J. T. University of Pennsylvania.
- Karlsson, J. 1994, Straff, behandling eller rehabilitering? (Punishment, treatment or rehabilitation?) Faculty of Arts, Åbo Akademi.
- Kidder, R., McEwen, C. 1989, Taxpaying Behaviour in Social Context: A Tentative Typology of Tax Compliance and Non-compliance. Taxpayer Compliance, Vol 2, Edited by Roth, J. A., Scholz, J. T. University of Pennsylvania.
- Kolm, A-S., Larsen, B. 2004, Does tax evasion affect unemployment and educational choice? IFAU – Institute for Labour Market Policy Evaluation, Uppsala. Working Paper No 2004:4.
- Korsell, L. 2002, Skatt, risk och brott (Tax, risk and crime). Expertrapport 3 till skattebasutredningen (Expert report 3 to the Swedish Tax Base Commission), SOU 2002:47.
- Korsell, L. E., 2003, Straff och självregulering – en strategi för reglering och kontroll av ekobrott (Punishment and self-regulation – a strategy for regulation and investigation of economic crime). Manuscript commissioned by the Swedish commission of trust.
- Korsell, L. E., Nilsson, M. 2003, En strategi för att förebygga ekobrott (A strategy for preventing economic crime). BRÅ Rapport 2003:10, Förebyggande metoder mot

ekobrott – En antologi (Preventive methods against economic crime – An anthology), ed.: Korsell, L. E. Brottsförebyggande Rådet, Stockholm.

Korsell, L. E., Nilsson, M., 2003, Att förebygga fel och fusk – Metoder för reglering och kontroll (Preventing error, non-compliance and fraud – Methods for regulation and audit activity). Norstedts Juridik, Stockholm.

Kurtén, T. Vad betyder det att skattefusk är orätt? RAMP-materialet och en diskussion kring rätt och moral (What does it mean that tax evasion is wrong? Material from the RAMP study and a discussion of rights and moral values).

<http://www.abo.fi/fak/hf/filosofi/Research/Larm/moralratt.html>

Lappalainen, T. 1993, Maffia. Fisher & Co, Stockholm.

Larsson, M. 2003, Straffvärde – och särskilt om straffvärdebedömningen vid misshandel och stöld (Culpability – with special emphasis on assessing culpability in cases of assault and theft). Faculty of Law, University of Lund

Lederman, L. 2003 a, Tax Compliance and the Reformed IRS. George Mason University, School of Law, Law and Economics Working Paper Series, Research Paper no 03-13 and The University of Texas, School of Law, Public Law & Legal Theory Research Paper Series, Research Paper No 50. <http://ssrn.com/abstract=391134>

Lederman, L. 2003 b, The Interplay Between Norms and Enforcement in Tax Compliance. George Mason University, School of Law, Law and Economics Working Paper Series, Research Paper no 03-12 and The University of Texas, School of Law, Public Law & Legal Theory Research Paper Series, Research Paper No 49. http://papers.ssrn.com/sol3/delivery.cfm/SSRN_ID391133_code030328570.pdf?abstractid=391133

Lindbäck, A. 1997, Hushållens beteende – incitament och sociala normer. (Households' behaviour – incentive and social norms). Ekonomisk Debatt, Vol 25, No 5.

Lissack, M., R. 1996, Chaos and Complexity – What does that have to do with management? Research Associate, Henley Management College, UK.

Mååg, C., Sunehag, L. 2003, Myndigheter och attitydförändrande kampanjer (Authorities and attitude-changing campaigns). University of Linköping, Linköping. <http://www.ep.liu.se/exjobb/eki/2003/ep/005/exjobb.pdf>

Malmer, H. 2002, Tankar om ändring i skattebrottslagen och reglerna om skattetillägg (Thoughts on changes to the Swedish Tax Crimes Act and the rules on tax penalties). Unpublished.

Malmer, H. 2003, Granskningen av inkomstdeklarationer under 100 år (Auditing a century of income tax returns). From “Deklarationen 100 år och andra tillbakablickar”, Riksskatteverket (Swedish Tax Agency), Stockholm.

McKerchar, M. Understanding and predicting taxpayers' behavioural responses to actions by tax administrations. <http://www.oecd.org/dataoecd/9/49/2789937.pdf>

Minnesota Department of Revenue 1994, The Minnesota Income Tax Compliance Experiment.
http://www.taxes.state.mn.us/taxes/legal_policy/research_reports/content/complnce.pdf

Molander, P. 1997, Comments on Tullberg. Ekonomisk Debatt, Vol 25, No 5.

Murphy, M. 2003, "Trust me, I'm the taxman": The role of trust in nurturing compliance (draft). Centre for Tax System Integrity, The Australian National University. <http://ctsi.anu.edu.au/UP.Murphy.trustme.pdf>

Nielsen, D-E. 2003, Servicetrappan – Tull och näringsliv i partnerskap för brottsförebyggande insatser (The service stair - Customs and business in partnership to prevent crime). BRÅ Rapport 2003:10, Förebyggande metoder mot ekobrott – En antologi (Preventive methods against economic crime – An anthology), ed: Korsell, L. E. Brottsförebyggande Rådet, Stockholm.

OECD, 2004, Managing and improving tax compliance. Draft, Guidance Note. Centre for Tax Policy and Administration.

Pedersen, S. 2004, Sort arbejde i Danmark, Norge, Sverige, Tyskland og Storbritannien (Illicit work in Denmark, Norway, Sweden, Germany and Great Britain), Rockwoolfondens forskningsenhed.

Riksskatteverket, 2000, Utredningsformen revision och produktivitet – sammanställning och analys av statistik (Field audits and productivity – compilation and analysis of statistics). Swedish Tax Agency. Unpublished.

Rothstein, B. 2003, Sociala fällor och tillitens problem (Social traps and the problem of trust). SNS Förlag, Kristianstad.

Rothstein, B. 2004, Lecture in Växjö 2004-05-11 on " Vad säger forskningen om kopplingen mellan myndigheternas sätt att sköta sin verksamhet och normbildningen i samhället?" (What does research say about the link between the way the authorities do their job and the formation of norms in society?)

RRV 1998:28, Svart arbete 2 – Omfattning (Illicit work 2 – Scale). Riksrevisionsverket (Swedish National Audit Office), Stockholm.

RSV 186, 1999, Kontrollpolicy and Kommentarer till RSV-koncernens kontrollpolicy (Audit activity policy and Comments on the Swedish Tax Agency group's audit policy). Swedish Tax Agency, Solna.

RSV Rapport 1983:1, Skatter och skattekontroll – Förutsättningar för en effektiv kontrollverksamhet (Taxes and tax audit activity – Prerequisites for effective audit activity). Swedish Tax Agency, Solna.

RSV Rapport 1983:2, Skatter och skattekontroll – Förutsättningar för en effektiv kontrollverksamhet, Sammandrag (Taxes and tax audit activity – Prerequisites for effective audit activity, Summary). Swedish Tax Agency, Solna.

RSV Rapport 1998:3, Skattefel och skattefusk – En utvärdering av skattekontrollen 1992 – 1997 (Tax gap and tax evasion – An evaluation of the tax audit activity 1992 – 1997). Swedish Tax Agency, Solna.

RSV Rapport 2000:2, Service och kontroll – En fördjupad analys av skattebetalarnas attityder och värderingar (Service and audit activity – An in-depth analysis of taxpayers' attitudes and values). Swedish Tax Agency, Solna.

RSV Rapport 2001:1, Om gratislotter och preventiv effekt – En utvärdering baserad på de skatteskyldigas avdrag för övriga kostnader under inkomst av tjänst och skattemyndigheternas kontroll av dette avdrag (On free lottery tickets and preventive effect – An evaluation based on taxpayers' deductions of other expenses from income from employment and the tax authorities auditing of these deductions). Swedish Tax Agency, Solna.

RSV Rapport 2002:12 Företagens synpunkter på skattesystemet, skattefusk och myndigheternas kontroll – Resultat från en riksomfattande undersökning våren 2002 (Companies' views on the tax system, tax evasion and the authorities' audit activity – Results of a nationwide survey 2002). Swedish Tax Agency, Solna.

RSV Rapport 2002:14 Om tillämpningen av skattetillägg och skattekontrollens preventiva effekt (On the application of tax penalties and the preventive effect of tax audit activity). Swedish Tax Agency, Solna.

RSV Rapport 2003:1 Allmänhetens synpunkter på skattemyndighetens sätt att arbeta – Resultat från en riksomfattande undersökning hösten 2002 (The general public's views on the tax authority's working methods – Results of a nationwide survey autumn 2002). Swedish Tax Agency, Solna.

RSV Rapport 2003:2 Allmänhetens synpunkter på skattesystemet, skattefusk och myndigheternas kontroll – Resultat från en riksomfattande undersökning oktober-november 2002 (The general public's views on the tax system, tax evasion and the authorities' audit activity – Results of a nationwide survey October-November 2002). Swedish Tax Agency, Solna.

RSV, 2002, Skatteekonomiskt meddelande nr 24. Uppföljning av kontroll av utlandsregistrerade aktiefonder (Tax-economic report no 24. Follow-up of audit of foreign-registered unit trusts). Swedish Tax Agency, Solna.

RSV, 2003, Skatteekonomiskt meddelande nr 33. Beslut under risk och osäkerhet. Kan Prospect Theory tillföra något i riskvärderingen? (Tax-economic report no. 33. Decision-making under risk and uncertainty. Can Prospect Theory add something to risk assessment?). Swedish Tax Agency, Solna.

Sandberg, A. 1999, Ett spel om moral och evolution (A game of moral values and evolution). <http://www.nada.kth.se/~asa/Texts/moral.html>

Schaub, G. 2001, Deterrence, Compellence and Prospect Theory. University of Pittsburgh.

Schneider, F., Braithwaite, V., Reinhart, M. 2001, Individual Behaviour in Australia's Shadow Economy: Facts, Empirical Findings and Some Mysteries. Centre for Tax System Integrity, The Australian National University. Working Paper No 19. <http://ctsi.anu.edu.au/WP19.pdf>

Sherman, L. W. Domestic Violence and Defiance Theory: Understanding Why Arrest Can Backfire. <http://www.aic.gov.au/publications/aust-violence-2/sherman.pdf>

Skattestatistik årsbok 2003 (Tax Statistical Yearbook of Sweden 2003). RSV 152 Vol 6, Swedish Tax Agency, Solna.

SKV Rapport 2004:5, Våra attityder och Viljan att göra rätt för sig (Our attitudes and Willingness to do the right thing). Swedish Tax Agency, Solna.

SOU 2002:47, Våra skatter? Betänkande från Skattebasutredningen (Our taxes? Report from the Swedish Tax Base Commission). Fritzes, Stockholm.

Sour, D. L. 2001, An Analysis of Tax Compliance for the Mexican Case. Irving B Harris School of Public Policy, Chicago.

Stiftelsen Frieschsenteret for samfunnsøkonomisk forskning 2002, Svart arbeid fra 1980 til 2001 (Illicit work from 1980 to 2001).

Sun Tzu, The Art of War. Sterling Publishing Company Inc 1990.

Tännsjö, T. 2000, Grundbok i normative etik (The basics of normative ethics). Thales, Stockholm.

Taylor, N. 2001 a, Understanding Taxpayer Attitudes Through Understanding Taxpayer Identities. Centre for Tax System Integrity, The Australian National University. Working Paper No 14. <http://ctsi.anu.edu.au/WP14.pdf>

Taylor, N. 2001 b, Taxpayers Who Complain About Paying Tax: What Differentiates Those Who Complain From Those Who Don't. Centre for Tax System Integrity, The Australian National University. Working Paper No 9. <http://ctsi.anu.edu.au/WP9.pdf>

Torgler, B. Tax Morale and Tax Compliance: International Comparisons, Inter-temporal Aspects, and Tax Simplicity. University of Basel.

Tullberg, J. Etiska normer och agerande i ett ekonomiskt experiment (Ethical norms and actions in an economic experiment). <http://www.tullberg.org/Papers/Thesis4.pdf>

Tullberg, J. Moral Compliance and the Concealed Charm of Prudence. <http://www.tullberg.org/Papers/Thesis3.pdf>

Tullberg, J. Replik om evolutionens konsekvenser för etiken (Rejoinder on the consequences of evolution for ethics). *Filosofisk tidskrift*, Vol 18, No 2, pp 46-56.

Tyler, T. R. 2001, Trust and Law-Abidingness: A Proactive Model of Social Regulation. Centre for Tax System Integrity, The Australian National University. Working Paper No 16. <http://ctsi.anu.edu.au/WP16.pdf>

University of Arkansas, 2003, The dog ate my W2: Why taxpayers refuse refunds. News releases, April 10. http://advancement.uark.edu/news/NEWS_ARCHIVES/APR03/DOG.html

Valle, V. 2000, Chaos, Complexity and Deterrence. National War College. <http://www.ndu.edu/library/n2/n005605j.pdf>

Viby Mogensen, G. 2003, Den samlede underdeklaration i Danmark (The total underreporting of income in Denmark). Rockwoolfondens forskningsenhed. <http://www.rff.dk/nyhedsb/jun2003.pdf>

Webley, P. 2002, Tax Compliance. Chapter from Economic Crime presented at Linköping International Conference on Economic Crime 2002.

Wennergren, U. K. 2003, Om attitydförändring i statlig förvaltning (On changing attitudes in government administration). Unpublished.

Wenzel, M. 2001 a, Misperception of Social Norms about Tax Compliance. Centre for Tax System Integrity, The Australian National University. Working Papers Nos 7 & 8. <http://ctsi.anu.edu.au/WP7.pdf> , <http://ctsi.anu.edu.au/WP8.pdf>

Wenzel, M. 2001 b, Principles of Procedural Fairness in Reminder Letters and Awareness of Entitlements: A Prestudy. Centre for Tax System Integrity, The Australian National University. Working Paper No 10. <http://ctsi.anu.edu.au/WP10.pdf>

Wenzel, M. 2002 a, An Analysis of Norm Processes in Tax Compliance. Centre for Tax System Integrity, The Australian National University. Working Paper No 33. <http://ctsi.anu.edu.au/WP33.pdf>

Wenzel, M. 2002 b, Dilemmas of Cooperation and Compliance: Identity, Justice and Norms. The Australian National University, Canberra, Australia. <http://www.ifbf.unizh.ch/orga/downloads/EGOS2002/Wenzel.pdf>

Wright, S. 2003, Enabling for Compliance. Inland Revenue, UK.

Zak, P. 2003, The Neurobiology of Trust. Corante Tech News, August 11, 2003. <http://www.corante.com/brainwaves/archives/000447.html>