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# Enforcement strategies

## How enforcement can improve tax compliance

*“Even if the open windows of science at first make us shiver  
after the cosy indoor warmth of traditional humanising myths,  
in the end the fresh air brings vigour,  
and the great spaces have a splendour of their own.”*  
Bertrand Russell

<b>SUMMARY.....</b>	<b>3</b>
<b>1 INTRODUCTION.....</b>	<b>5</b>
<b>2 WHAT DOES THE RESEARCH SAY? .....</b>	<b>6</b>
2.1 STUDIES OF THE EFFECT OF ENFORCEMENT SHOW MIXED RESULTS.....	6
2.2 THE SIGNIFICANCE OF SOCIAL AND PERSONAL NORMS.....	8
2.3 CROWDING THEORY – THE DYNAMIC BETWEEN ENFORCEMENT AND NORMS .....	9
2.4 THE SLIPPERY SLOPE MODEL – THE DIFFERENCE BETWEEN COERCIVE AND LEGITIMATE POWER ...	10
<b>3 A POSSIBLE EXPLANATORY MODEL .....</b>	<b>13</b>
3.1 MOTIVES MATTER .....	13
3.2 DOES THIS ALSO APPLY TO SERIOUS TAX EVASION AND BUSINESS TAXPAYERS? .....	15
3.3 COMPARISON WITH THE CLASSICAL THEORY IN COMPLIANCE RESEARCH.....	17
3.4 COMPARISON WITH THE SWEDISH TAX AGENCY’S DEVELOPMENT.....	18
3.5 PERCEIVED RISK OF DETECTION AS A RESULT, NOT A CAUSE .....	19
<b>4 THE IMPORTANCE OF THE ENVIRONMENT .....</b>	<b>21</b>
4.1 CONTEXT AND PERCEPTIONS MATTER .....	21
4.2 HOW WE FRAME TAXES MATTER .....	23
<b>5 DIFFERENT TYPES OF PREVENTIVE EFFECT.....</b>	<b>24</b>
5.1 DIFFERENT EFFECTS DEPENDING ON THE TYPE OF ERROR.....	24
5.2 THE GENERAL PREVENTION EFFECT IS MOST IMPORTANT.....	26
<b>6 BETTER UNDERSTANDING BY USING A SYSTEM APPROACH.....</b>	<b>27</b>
6.1 ENFORCEMENT AS PART OF A COMPLEX SYSTEM.....	27
6.2 COMPLEX ADAPTIVE SYSTEMS ARE NOT COMPLICATED.....	29
<b>7 HOW TO IMPROVE THE EFFECT OF ENFORCEMENT .....</b>	<b>30</b>
7.1 USE ENFORCEMENT TO STRENGTHEN SOCIAL NORMS .....	30
7.2 MAKE SURE THE ENFORCEMENT IS LEGITIMATE. . . ..	33
7.3 ... AND TREAT PEOPLE WITH RESPECT.....	34
7.4 FOCUS ON WHAT PEOPLE DO, NOT ON HOW THEY ARE .....	35
7.5 SANCTION THE ACT, NOT THE PERSON .....	36
7.6 ALSO USE SYSTEM-LEVEL MEASURES .....	37
7.7 BE CREATIVE .....	39
7.8 DON’T LOOK AT ENFORCEMENT IN ISOLATION.....	41
7.9 ADD NEW TYPES OF SELECTION.....	42
<b>8 CONCLUSIONS .....</b>	<b>43</b>

## Summary

This report describes new possibilities in enforcement strategies and how their application can lead to improved tax compliance.

### **Complex connections behind the effects of enforcement**

Studies of the effects of enforcement indicate that they can vary and even be contradictory. Enforcement can lead to increased tax evasion, reduced tax evasion, or not affect behaviour at all. This doesn't mean that some studies manage to obtain the 'right' answers, while others get it mostly wrong. The only reasonable approach is to assume that all studies have something to contribute in terms of knowledge and understanding.

The research also furnishes knowledge that can explain these seemingly conflicting effects. The effects of enforcement vary greatly depending on how and in what context it is carried out. Many different factors influence the effects of enforcement, and the context influences the effects just as enforcement influences the context. This means that different effects are to be expected, and that it is difficult to predict the effect of a specific enforcement activity.

### **Norm reinforcement or deterrence**

Enforcement can either reinforce or weaken the will to do the right thing. This means that enforcement functions in different ways which are mutually exclusive. The choice here is between enforcement influencing norms in society and thereby the will to do the right thing, and enforcement being a deterrent by using threats to make people act in a certain way. In the latter case, the will to do the right thing is weakened. Still, the effect on behaviour can be the same: that people actually do the right thing. The question is thus whether we want taxpayers to want to do the right thing (and therefore also do it), or whether we want to coerce people into a specific behaviour, regardless of what they want. The Swedish Tax Agency has already made its choice, as implied by the vision of a society in which everyone is willing to do their fair share. People's motives matter.

### **Focusing on the will to do the right thing and on preventive effects**

It follows that enforcement should be managed with the purpose to influence the will to do the right thing. This in turn means that the main function of enforcement is to influence norms.

This also means that the preventive, norm reinforcing effect of enforcement is the most important and cost effective one. Prevention in this context should refer to the effect of enforcement on the system as a whole, i.e. the effect on the entire taxpaying collective over time. It remains important for enforcement to be directed towards areas with large and

serious errors, but the effect of enforcement is primarily at the system level rather than on the particular group to which enforcement is applied. Enforcement must be seen as a means for increasing the will to do the right thing, not as an end in itself. The effects of enforcement can better be understood if enforcement is seen as part of a complex system.

#### **The qualitative aspects of enforcement are crucial to its result**

The will to do the right thing will increase, and trust in the tax authority grow, if enforcement is perceived as legitimate, supportive and fair. This means that enforcement must not be perceived as toothless or insufficient; it must be capable of convincing people that others do the right thing. Neither, however, must enforcement be perceived as disproportionately harsh, invasive or comprehensive, as it will then lose its legitimacy. If enforcement is perceived as legitimate, qualitative aspects such as who is the subject of enforcement and how enforcement is carried out will be very significant for the outcome.

#### **Enforcement is most effective in conjunction with other measures**

Enforcement has considerable potential for positive effects, but this requires enforcement to be combined with other measures. Enforcement combined with system-level measures such as staff ledgers and certified cash registers are good examples of this. Good and carefully considered communication are other prerequisites for good effect outcomes of enforcement. Communication about enforcement measures can produce immediate effects, but it is of course a requirement that the measures are carried out.

#### **Focusing on influencing circumstances and conditions**

The aim of enforcement as a system-level measure is to influence taxpayers' circumstances and conditions. Small changes to these circumstances and conditions can have considerable effects on behaviour. This is often a more effective approach than trying to change taxpayers directly. The view should not be that errors and tax evasion occur because there is something wrong with the taxpayers, but because conditions are less than optimal. It's not the taxpayers who are the problem; instead they can be part of the solution by contributing to the development of conditions. In keeping with this, enforcement should not be directed at taxpayers on the basis of how they are, but only on the basis of what they do.

## 1 Introduction

As with all other activities, the Swedish Tax Agency's enforcement needs development. And such development has been going on continuously, on selection, working methods, prioritisations as well as in planning. But a more systematic review based on research and reasoning has not really been carried out since 1998, when the 'Errors and tax evasion' report<sup>1</sup> was presented. It made the following observation:

*The mechanisms that create a preventive effect are complex and little known. A lot of resources are spent on enforcement, but there is hardly any research that looks at the preventive effect of enforcement.*

The situation today is completely different. There is a considerable body of research about the effects of enforcement and about taxpayers' behaviour. But this research indicates that effects vary. For example, enforcement can increase the will to do the right thing, but also reduce the will to do the right thing, and enforcement can similarly increase or reduce the perceived risk of detection. Thus enforcement can lead to reduced as well as to increased tax evasion. Enforcement does not produce simple, unequivocal and completely predictable effects. But the research has also provided a sufficient understanding of how enforcement works to allow it to explain these seemingly conflicting results.

In other words it's not about determining that certain studies are 'right' while others are 'wrong'. Instead the ambition must be to understand and interpret existing results in such a way that it becomes possible to explain the different results.

One of the things that the research indicates is a need to understand the interplay between norms (including the will to do the right thing) and enforcement, and the interplay between trust and enforcement. This also involves seeing the deterrent effect of enforcement as something other than its norm-reinforcing effect. Researchers such as Michael Wenzel, Bruno Frey and Erich Kirchler have, in different ways, contributed new knowledge that makes it possible to understand the functioning of enforcement. Research in areas such as behavioural economics also has valuable knowledge to contribute, that makes it easier to understand the functioning of enforcement. Taken together, this indicates that taxpayers' behaviour is more readily understood if we regard enforcement as part of a complex system.

An understanding of how enforcement functions and how its effects occur is crucial to establishing how enforcement should be developed; this knowledge will lead to new approaches, which may be sufficient in itself to bring about development.

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<sup>1</sup> Internal report from the Swedish Tax Agency, "Fel och fusk" Rapport RSV 1998:3.

In addition to this, it is important to consider the changed conditions resulting from the fact that tax administrations today work in partly new ways. Cooperation with taxpayers and their representatives is becoming increasingly common. At the same time, technical developments create new possibilities to make it easy to get it right and hard to get it wrong. These changes also influence enforcement.

This report will deal mainly with the effects of enforcement on intentional tax evasion. The term ‘evasion’ is used precisely to emphasise that the behaviour is intentional. A distinction is made between serious tax evasion and less serious tax evasion (designated ‘minor tax evasion’) – not on the basis of any specifications in terms of amounts, but rather on how it is perceived by the vast majority of people. Unintentional errors can also be affected by enforcement, but usually in the sense that enforcement is used as a means to educate the taxpayer. When the term ‘error’ is used in this report it refers to both intentional tax evasion and unintentional mistakes.

## 2 What does the research say?

Relevant research to examine is of course different studies on the effect on enforcement activities but also studies on how enforcement works and how it can influence attitudes and behaviour.

### 2.1 Studies of the effect of enforcement show mixed results

What influence does enforcement have on the degree of voluntary compliance? The research doesn’t provide an unequivocal answer. There are very many studies of different kinds and their results are varied. Sometimes they show that enforcement increases the degree of compliance, other times that it reduces it, and yet other times that it doesn’t make any difference. With regard to the deterrent effect of enforcement, the OECD<sup>2</sup> laconically notes that *‘The relationship between deterrence and tax compliance is complex. Research on the effect of deterrence conducted by revenue bodies and academic research show different results.’*

A study of enforcement in Germany shows that it isn’t always easy to understand its effects. A Danish research foundation, the Rockwool Foundation, and researchers Lars Feld and Claus Larsen carried out a study<sup>3</sup> in 2005 to find out why the informal economy had contracted in Germany. In 2004 the informal economy in Germany shrank for the first time in three decades, from 4.1 per cent of GDP to 3.1 per cent. Along with a number of other measures, Germany had increased the frequency of enforcement and raised penalties. The question was whether increased enforcement was the main cause.

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<sup>2</sup> OECD, 2010, ‘Understanding and Influencing Taxpayers’ Compliance Behaviour’. FTA.

<sup>3</sup> ‘Black Activities in Germany in 2001 and in 2004. A Comparison Based on Survey Data.’ News From The Rockwool Foundation Research Unit.

Surveys showed that taxpayers felt there was a greater risk of detection. On the basis of this data alone, it is tempting to draw the conclusion that increased enforcement has led to an increased risk of detection, which in turn has led to people doing less undeclared work.

But Germany had also, in addition to increasing the frequency of enforcement and raising penalties, made changes to tax and labour market legislation. The researchers therefore decided to add a parameter to the study, which they called tax morals and social norms.

The results indicated that an increased risk of detection and of penalties did not have any effect whatsoever on people's tendency to participate in the informal economy. Social norms had a considerable effect on women's tendency to participate in the informal economy, and a marginal effect on men's tendency to do so.

The researchers concluded that social norms are what determine behaviour, and made the following remark in the closing section of their report: 'How the relationship between the state and its citizens shapes tax compliance and black activities is much more complex than might appear at first sight, but so far the evidence does not point to increased deterrence as the factor behind the reduction of black activities.'

Another Danish study, from 2011, showed that enforcement had a significant effect on those who had been audited, in that they declared a higher income for the year following the audit. A British study from 2012 showed that auditing those who had made errors led to increased compliance afterwards, but that auditing those who had filed correctly led to reduced compliance afterwards.<sup>4</sup>

Earlier studies, based on random audits in the US during the early 1990s, showed that enforcement had no effect at all. Another study from the US tried to assess the preventive effect of audits and found that there was possibly a very slight effect. When the effect of auditing VAT reporting in Argentina and Chile was investigated in 2006, no effects could be demonstrated. In an American study, the threat of an audit showed a certain effect in that individual traders reported higher incomes. However, the opposite applied for high income earners – they began reporting lower incomes.<sup>5</sup>

There are thus no clear and consistent results from the research in respect of the effects of enforcement, but it is nevertheless possible to draw conclusions from the research. Simply the fact that different studies give different results is valuable information in itself. Instead of assuming that some studies must be right and others wrong, we can assume that all of them have something to contribute and that the task is to find an explanatory model in which most of the results appear reasonable.

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<sup>4</sup> TARC, Tax Administration Research Centre, 'How Long Lasting are the Effects of Audits?', Arun Advani, William Elming & Jonathan Shaw, January 2015.

<sup>5</sup> Ibid.

Below are some descriptions of ideas and conclusions from three theories of the effects of enforcement. Together they form a pattern that allows us to see the variation across different studies as completely comprehensible and logical.

## 2.2 The significance of social and personal norms

Social norms exist in two variants: ‘ought to’ norms (prescriptive or injunctive norms) tell us how we should act according to the general view, and ‘do’ norms (descriptive norm) tell us how other people act. Personal norms are your own values and attitudes about what is right and wrong.

Our behaviour is governed to a considerable extent by personal norms, but these personal norms are social norms that the individual has internalised. In other words we are strongly influenced by social norms. These can apply for society as a whole or for larger or smaller groups which have something in common (e.g. location, age, profession or interest).

An Australian researcher, Michael Wenzel, has studied how norms and enforcement function together by means of a survey with just over 2000 respondents.<sup>6</sup> The survey included questions about respondents’ own tax evasion (which need not at all be the same thing as real tax evasion) and about views and attitudes. The following conclusions can be drawn from this study:

- Strong personal norms for paying taxes makes the deterrent effect of enforcement marginal (since there was no intention to evade taxes anyway). People who want to pay taxes are thus not influenced by enforcement.
- The deterrent effect of enforcement is greater if personal norms for paying taxes are weak. People who don’t want to pay taxes are thus influenced by enforcement. The effect of enforcement becomes even greater when there are social norms for paying taxes. This means that even if a person has not adopted the norm that you should pay tax, they will still be influenced by what others think and do. Formal sanctions have a greater effect if they are supported by informal sanctions in the form of social disapproval.

This means that the deterrent effect of enforcement can be expected to be small or non-existent when personal norms are strong (for paying tax), that the deterrent effect is greater when personal norms are weak, and even greater when personal norms are weak in combination with strong social norms.

In other words, the deterrent effects of enforcement are dependent to a great extent on the context, and on which taxpayers are subject to it. The deterrent effect of enforcement is

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<sup>6</sup> ‘The social side of sanctions: personal and social norms as moderators of deterrence’, Working paper no 34, Centre for Tax System Integrity, October 2002.



high when the will to do the right thing is low. The deterrent effect of enforcement is low when the will to do the right thing is high. Since the goal is that the will to do the right thing should be high, the conclusion is that it is positive if the deterrent effect of enforcement is perceived as small.

### 2.3 Crowding theory – the dynamic between enforcement and norms

Crowding theory is a view of the connection between enforcement and norms, presented by the researcher Bruno Frey.<sup>7</sup>

This thinking is founded on the notion that there is a difference between internal and external motivation or, expressed differently, a difference between personal norms (will) and incentives in the shape of formal or informal sanctions. The question, then, is whether a person does the right thing because s/he wants to, or whether it is due to some form of external pressure. Pressure is often a matter of sanctions, but can also refer to rewards for the desired behaviour.

Traditional thinking has it that the stronger the incentive (in the form of sanctions), the higher the degree of compliance. Crowding theory says that this is not always the case, and that external incentives can actually reduce the degree of compliance. External incentives can push the internal will out, in what is termed a crowding-out effect. But the opposite can also happen – external incentives can strengthen the internal will. In this case a crowding-in effects occurs. The effect of external incentives can thus vary, and result in anything between the strongly positive and the strongly negative. We cannot say that sanctions always have a certain effect – instead it depends on the context.

Which effect will dominate is determined by whether the individual perceives the external incentive as controlling or supportive. If the incentive is perceived as controlling, i.e. as coercion, the will to do what was intended becomes reduced. The internal conviction, or the personal norm, is substituted for the external pressure. If the individual's will to do something is not recognised and appreciated, the value of this will is reduced. A person who is ordered or coerced to do something that s/he actually wants to do doesn't get a chance to show his/her good will, thereby losing his/her motivation.

But if the incentive is perceived as supportive instead, the will to do what was intended can increase. Supportive incentives are not perceived as coercion – rather, the individual perceives a chance to make his/her own choice. As there is an incentive, this strengthens the individual's own view of what is right. If the person wants to do the right thing, and also perceives incentives as supportive, this serves as confirmation that his/her will is right, thus strengthening it.

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<sup>7</sup> Bruno S Frey & Reto Jegen, 2001, 'Motivation Crowding Theory', University of Zürich.

One example of a type of behaviour which is in line with crowding theory is people's inclination to do volunteer work. People who receive remuneration are less inclined to do volunteer work. Remuneration is still important though; those who receive more in remuneration are willing to work more. But no remuneration at all leads to the greatest work input. The will to do something is a powerful motivation. An external incentive, such as money, can replace this motivation. But it can take very considerable remuneration to make the external motivation stronger.<sup>8</sup>

## 2.4 The slippery slope model – the difference between coercive and legitimate power

In 2007 Erich Kirchler, an Austrian psychologist, presented (together with Erik Hoelzl and Ingrid Wahl) a model of compliance that distinguished between enforced compliance and voluntary compliance, which they called the 'Slippery slope framework'.

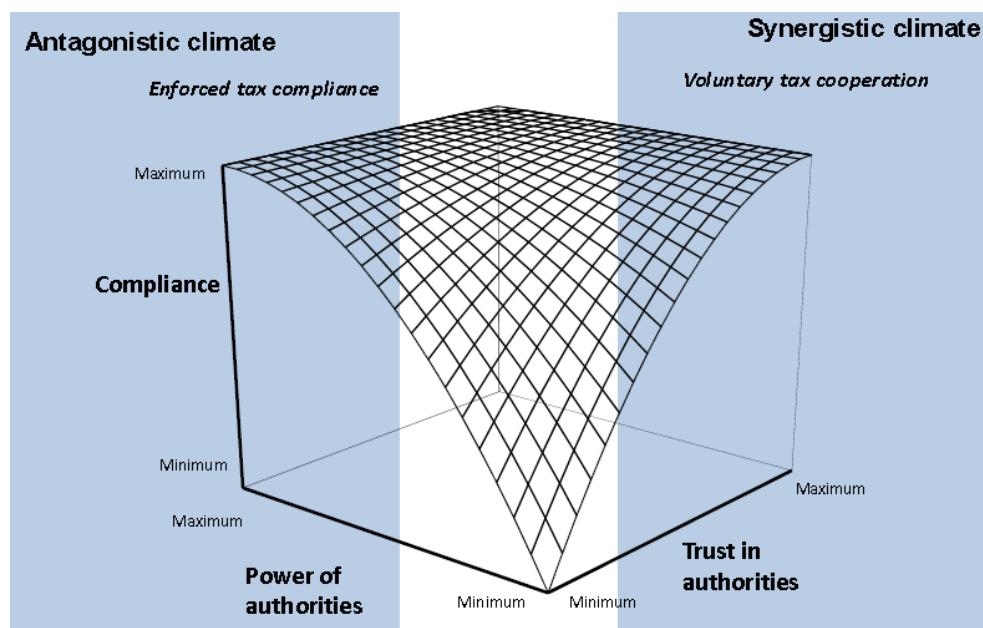


Figure 1. The Slippery Slope Model according to Erich Kirchler et al.

The model states that compliance can be achieved either through coercion and the exercise of power, or by building trust. This creates two different 'compliance climates', one antagonistic and one synergistic.

There is empirical support for the notion that power contributes to compliance, as well as for the notion that trust contributes to compliance. In that respect the model is accurate. What has been less clear is how power and trust function together. Empirical studies

<sup>8</sup> Dan Ariely, 2008, 'Predictably Irrational – The Hidden Forces that Shape our decisions'.

indicate that power destroys trust. But there are also studies which show that compliance is highest when both power and trust are present to a considerable extent.

In other words, power can both reduce and increase trust in tax authorities. Kirchler's new thinking deals with explaining this. His solution is to differentiate between types of power – in this case between coercive power and legitimate power. Kirchler also differentiates between rational trust and implicit trust. This complicates the model, but increases its explanatory power considerably.

Coercive power is about pressure based on sanctions (or rewards). A person who breaks the rules will suffer monetary, physical or psychological costs. Compliance is created by means of threats and deterrence.

Legitimate power is based on identifying with the wielder of power. Compliance is created when the wielder of power is seen as a legitimate, informed expert doing the right thing.

Rational trust is about the citizen basing his/her trust on actual circumstances and conscious assessments. Trust arises when there are good reasons to take the authority at its word.

Implicit trust is about an unconscious reaction. Trust arises in situations where all participants, both individual people and authorities, have the same social identity. Social norms imply that everyone within one and the same group that you can identify with can also be trusted.

Coercive power destroys trust, both the rational and the implicit kind. Legitimate power, by contrast, creates rational trust. There are three explanations for this: 1) legitimate power creates fairness by making it difficult for others to cheat, 2) legitimate power contributes to making procedures fair, and 3) legitimate power can show that many people are doing the right thing.

Legitimate power leads to rational trust. Conversely, a high level of trust leads to power being perceived as legitimate. They mutually reinforce each other, and both strengthen the will to do the right thing. Therefore this ought to be effective.

Coercive power, then, cannot be combined with trust. But legitimate power can create rational trust, and implicit trust is created completely without power. Kirchler describes these different states as three different compliance climates (instead of the two we had before): antagonistic, service-based and trust-based.

### **Antagonistic climate**

Here coercive power dominates. Compliance is created by means of extensive enforcement and harsh sanctions. This leads to a vicious cycle in which mistrust grows, and this leads to

reduced compliance which in turn requires increased power, and so on. The attitude is that the tax administration and the taxpayers are opponents working against each other.

### Service-based climate

‘Service’ has here a broad meaning. It involves legitimate power and rational trust in everything the authority does, including enforcement. Taxpayers expect a fair and supportive authority characterised by professional goodwill. Fairness in this context also refers to the authority ensuring that others do the right thing. Taxpayers who find the authority helpful and competent in all respects become trustful of it and want to do the right thing.

### Trust-based climate

Implicit trust dominates. This means that taxpayers and authorities trust each other. The tax administration operates on the assumption that it is there to look after the taxpayers’ interests. Taxpayers act like responsible citizens, and make conscious choices to comply. Kirchler admits that a system entirely without enforcement and power is utopian, but maintains that a system with rational trust can develop towards increasing levels of implicit trust.

It is unrealistic to imagine a tax system entirely without enforcement. A reasonable conclusion to draw from the model, however, is that enforcement should primarily be seen as a tool for ensuring that ‘everyone else’ does the right thing – and less as a tool for intimidating people into obeying. The aim is to operate in a way that is perceived as fair and conducive to trust, and to build a will to do the right thing by using legitimate power which leads to rational trust. If this also creates implicit trust to some extent, that is of course welcome.

This means that a service-based climate (which can also extend into a trust-based climate) is the preferable one. The following correlations from Kirchler’s experiment show that this can lead to greater trust and higher levels of compliance.

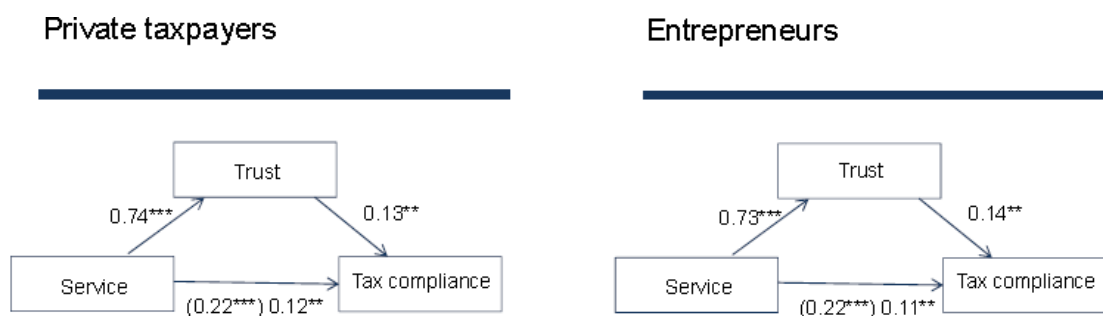


Figure 2. Correlations between a service-based climate, trust and compliance according to Erich Kirchler et al.

Service, then, does not only suggest support given to taxpayers, but a climate based on legitimate power and rational trust. Enforcement is a part of this. The figure shows that this climate has a strong correlation with trust and a weaker, but still positive, correlation with compliance. The connection with compliance occurs both directly (the climate increases the will to do the right thing) and indirectly (the climate creates trust which in turn increases the will to do the right thing). Broadly speaking, there is no difference here between private individuals and businesses.

### **3 A possible explanatory model**

#### **3.1 Motives matter**

To some extent, the three theories described above say the same thing. They say that enforcement can strengthen the will to do the right thing, and that coercion and threats cannot be combined with a will to do the right thing. Thus enforcement can be used either to strengthen the will to do the right thing or to threaten and coerce – but not both at the same time.

This is a critical conclusion, and one that implies a strategic choice. Every tax authority must choose whether they are interested in increasing the will to do the right thing or whether they are only interested in the actual behaviour, irrespective of what people want. In other words, the question has to be asked if people's motives for doing the right thing are interesting, or if it is only the behaviour which is interesting.

The way enforcement works can be described by means of two extremes: enforcement can either force people to do the right thing or increase the will to do the right thing. Since both methods work for influencing behaviour, the question has to do with which method you judge to be best on the basis of e.g. cost effectiveness and/or ethical considerations.

The figure below summarises these conclusions.



There is also a time factor to consider. Direct deterrence can have an immediate effect on behaviour, which can be observed and linked to a specific measure. It can take time before norm reinforcing measures produce results in the form of changed behaviour (which requires that social norms are influenced and then become internalised as personal norms). In the latter case it isn't possible to prove that a specific norm reinforcing measure has had a specific effect on the behaviour of a defined group. What is possible to prove, however, is that norm reinforcement generally influences behaviour generally, albeit with a certain time lag.

An additional complicating factor in the interpretation of studies of the effects of enforcement is that different strategies for how you choose to use enforcement tend to be self-fulfilling. If you use enforcement to coerce and threaten, people will react to threats and coercion and not want to do the right thing (but may do anyway), which can be used to justify the chosen strategy. Conversely, a strategy that aims to increase people's will to do the right thing will lead to threats and coercion not working. In somewhat simplified terms you could say that if you treat people as greedy and scheming crooks, they will (to a greater extent) behave that way. If, instead, you try to create a more collaborative climate based on fairness and trust, people will (to a greater extent) behave accordingly.<sup>9</sup>

This is about the purpose of enforcement and about how enforcement is used. Enforcement should not, according to the Swedish Tax Agency's choice, be used for purposes of deterrence, although the very existence of enforcement will probably make some taxpayers feel deterred all the same. This in turn is about the effect and experience of enforcement for the individual, and need not be a problem – on the contrary, it can have a positive effect. The point here is that the tax authority should not make threats or use enforcement for the purpose of deterrence. This does not necessarily affect the extent of enforcement, but it does affect how enforcement is carried out and communicated, and thereby its long term effect on taxpayers as a group. But different taxpayers will nevertheless have different experiences. There is a difference between deterring (not good) and being deterred (can be OK).

### **3.2 Does this also apply to serious tax evasion and business taxpayers?**

Can the norm reinforcing effect of enforcement be expected to work for serious tax evasion and professional criminals as well? Are there situations in which deterrence is the only solution? As described above, a tax authority has to choose whether it wants to strengthen the will to do the right thing, or to deter. As soon as you choose deterrence, the will to do the right thing will be reduced. It isn't possible to increase and decrease the will to do the

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<sup>9</sup> Kirchler & Hoelzl, 2006, 'Modelling taxpayers behavior as a function of interaction between tax authorities and taxpayers in Managing and maintaining compliance'.

right thing at the same time. This is thus a strategic choice – you have to choose one or the other. A possible objection to this would be that criminals who don't want to do the right thing anyway will never be made to want to do the right thing, regardless of how the enforcement is carried out. This may be perfectly true, but still doesn't justify the tax authority applying threats and deterrence for certain groups. A discussion of an example may serve to explain this.

If the purpose of enforcement is to strengthen social norms, it should be directed at tax evasion that the majority of taxpayers find objectionable – often serious tax evasion and criminality. As a taxpayer, you want to know that tax evasion doesn't pay and that most people do the right thing. The purpose of enforcement, then, is to persuade the majority that this is precisely the case. The primary purpose of enforcement is not to try to change the behaviour of the criminals subject to enforcement, even if this may also be a desirable side effect of the norm reinforcing effect. If enforcement succeeds in influencing social norms, this will have an effect on criminality as well, but mainly by means of a long term process. When social norms for honest behaviour are strengthened, the social and moral costs of becoming a criminal increase, which reduces the recruitment of new criminals. On this view, then, enforcement is primarily about influencing those norms in society that influence people's behaviour. It's about an indirect effect on behaviour.

The deterrent effect, on the other hand, can be seen as a direct effect of enforcement. If the purpose of enforcement is to have a deterrent effect, it should be presented in as threatening a way as possible. It is probably the case that professional criminals as a group are the least easily intimidated, while more ordinary taxpayers are more easily intimidated into obedience. In other words, deterrence is probably not very effective against serious criminality. Deterrence will also influence the will to do the right thing not just among those who are subject to the direct threats, but among others too. This means that even if a tax authority only threatens certain specific groups of criminals, other taxpayers will also note these threats and perceive that this is how the tax authority operates: 'do the right thing, or else...'. This risks intimidating people into obeying, which may produce desirable effects on behaviour – but the will to do the right thing will not increase.

Thus norm reinforcement has the advantage of eventually influencing the entire group of taxpayers; and the stronger the social norms, the greater the effect of enforcement as its legitimacy increases. Deterrence, for its part, has the disadvantages that it works least well for those most involved with evasion, and that it will eventually reduce the will to do the right thing among all taxpayers, which may lead to a need for constantly escalating levels of enforcement.

Working with norm reinforcement also means that the Swedish Tax Agency needs to draw attention to behaviours that the majority of taxpayers find objectionable despite their being



completely legal. This includes certain forms of tax planning or tax avoidance. In these cases it is not always a question of enforcement (since the actions can be legal), but may involve other measures, e.g. pointing the effects out to legislators, or influencing taxpayers' behaviour in other ways. Businesses are not insensitive to social norms either – they are run by people, and personal as well as social norms influence how these people act within the business. Businesses additionally have commercial reasons to consider their reputation.

### 3.3 Comparison with the classical theory in compliance research

Research into 'tax compliance', or how you get people to pay tax, is often regarded as having begun with the publication of an article written by Michael Allingham and Agnar Sandmo in 1972<sup>10</sup>. Their basis is also classical economic theory, primarily inspired by the economist Gary Becker. The idea is that people evade tax if this is more profitable than paying it. The decision about whether to evade tax or not becomes an economic calculation carried out by rational individuals. It follows from this that tax evasion decreases if the risk of detection increases or if punishments become more severe.

Given the low risk of detection in most countries and the absence of draconian punishments, taxpayers should, in accordance with this theory, evade tax more than they actually do. This has led various researchers to develop the theory further by adding other costs, such as feelings of guilt and shame, and the risk of social stigma.

It is reasonable to assume that tax evasion will decrease if the cost of evading tax increases. Incentives matter. With a strategy of this kind, the interest of the tax authority will be in maximising the cost of tax evasion. It will then make sense to highlight the risk of detection and the punishments that exist, including the risk of social stigma. That is one reason why countries that have chosen this strategy are inclined to introduce 'naming and shaming', i.e. publishing the names of tax criminals. This is about deterrence and threats. In English-speaking contexts, the term 'deterrence' is often used. This thinking has had such a large impact that many people see enforcement or audits as synonymous with deterrence.

Incentives in the form of deterrence can work, at least up to a certain level. There are studies which show that increasing punishment leads to increased compliance, but when the punishments become too severe, the opposite effect occurs.<sup>11</sup> If punishments are perceived as unfair and unreasonable, there is a risk of provoking people into increased tax evasion. The idea that people choose a higher cost in order to uphold a principle is not in line with classical economic theory. As will be described below, research in behavioural economics indicates that we humans often act in ways that are contrary to classical economic theory.

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<sup>10</sup> Journal of Public Economics, 1 (1972) 323–338)

<sup>11</sup> Paul Webley, 2002, Tax Compliance. Chapter from Economic Crime presented at Linköping International Conference on Economic Crime 2002

But this report does not argue that deterrence and negative incentives don't work. Its argument is instead that a strategy based on norm reinforcement and on increasing the will to do the right thing is more cost effective (besides being more pleasant). Enforcement and sanctions thus remain decisive elements, but are used to a different end. The crucial point is that we have to choose what end we want to achieve. Deterrence reduces the will to do the right thing, while norm reinforcement increases the will to do the right thing. We cannot choose both.

### 3.4 Comparison with the Swedish Tax Agency's development

The Swedish Tax Agency's results have developed in a positive direction after 2006, as the following diagram shows.

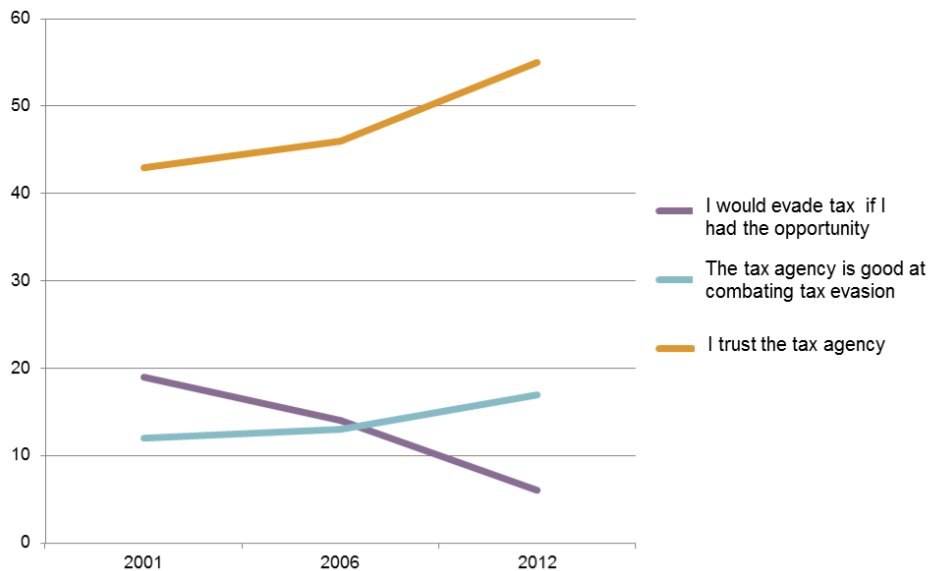


Figure 4. Per cent share of respondents agreeing with the statements. Results from the Swedish Tax Agency's questionnaire surveys. Figures shown are from the Citizen Survey of 2012, Swedish Tax Agency Report 2012:1.

In its annual report for 2013, the Swedish Tax Agency noted that *'... the tax gap, as a percentage of the gross national product (GNP), narrowed between 2007 and 2012.'* The annual report for 2014 also emphasises that the tax gap has narrowed. Most indicators for desirable effects are thus moving in the right direction.

There are likely to be several reasons for them, but these positive developments coincide with the Swedish Tax Agency's decision to adopt a completely new strategy. This new strategy put the focus on norm reinforcement and the importance of building trust. Even if the vision (A society where everyone is willing to do their fair share) has existed since 1998, it wasn't until 2006 that a strategy was formulated for how the vision might be realised.

The new strategy can be seen as a complete shift in outlook and in the view of the purpose of enforcement. The enforcement policy drawn up in 1998 contains the following formulation about what is meant by preventive effect.

*'... the taxpayer's assessment, before a contemplated tax evasion, of the risk of detection and the consequences of such detection, which makes the taxpayer desist from the contemplated action.'*<sup>12</sup>

This shows that the purpose of enforcement then was deterrence in the traditional sense. The Swedish Tax Agency has since moved very clearly towards an outlook and a working method that have become less and less about deterrence and more and more about norm reinforcement (a leftward shift in figure 3 above). The realisation has grown that the vision is not compatible with traditional deterrence.

However, it appears as if this 180-degree turn wasn't given very much attention, and that its significance was underestimated.

It is not possible to prove what significance this radical change of course has had. What is clear, however, is that over a period of several years the Swedish Tax Agency has gradually but increasingly adopted the ideas about norm reinforcement in place of traditional deterrence, and that this has coincided with a positive development of the will to do the right thing.

There are nevertheless reasons to clarify this choice of course further. Choosing norm reinforcement over direct deterrence is an important strategic, ethical and practical choice as it has wide-ranging consequences for how the Swedish Tax Agency reasons and operates.

### **3.5 Perceived risk of detection as a result, not a cause**

As mentioned above, just about all the curves point in the right direction after 2006. The perceived risk of detection is also increasing, as the diagram below indicates. Correlation between the will to do the right thing (described here as the share of respondents who would not conceal their income from taxation) and trust is marked, even if this should be interpreted with caution as only two measuring points are included (2006 and 2012). It is not unusual, however, for studies to show that a reduced inclination to evade tax is correlated with a perceived risk of detection.

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<sup>12</sup> Internal report from the Swedish Tax Agency, "Fel och fusk", RSV report 1998:3, p 159.

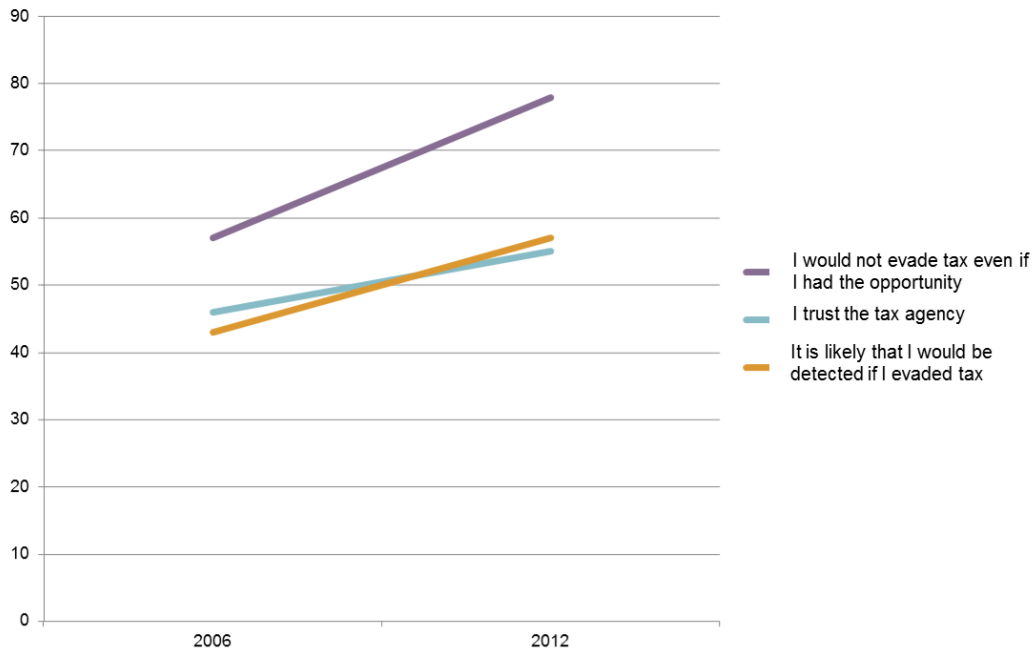


Figure 5. Per cent share of respondents agreeing with the statements. Results from the Swedish Tax Agency's questionnaire surveys. Figures shown are from the Citizen Survey of 2012, Swedish Tax Agency Report 2012:1.

These types of figures are often used as an argument that the perceived risk of detection should increase, and that enforcement has a deterrent effect which works. However, this isn't consistent with the earlier claim that the deterrent effect of enforcement is reduced when the will to do the right thing increases. How, then, can the will increase at the same time as the perceived risk of detection also increases?

If enforcement has a deterrent effect this leads to a reduced will to do the right thing, and we can also expect that the perceived risk of detection increases – and that the risk of detection is one reason why people don't evade tax. This scenario is entirely plausible. But since the situation in Sweden 2006 – 2012 was that the will actually increased, this cannot be an explanation that applies here at the moment.

Instead there are two other possible explanations. One is that there is no causal link whatsoever between the will to do the right thing and the perceived risk of detection, but that there is a strong correlation nonetheless. The other possible explanation is that the causal links go the other way, i.e. that the will to do the right thing in itself leads to a perceived greater risk of detection. The perceived risk of detection is measured by means of surveys, and it is easy to imagine that survey answers tend to be reconstructions after the fact, or a rationalisation of the respondents' actual behaviour. If you have evaded tax and not got caught, you perceive a low risk of detection; if you haven't evaded tax you perceive a high risk of detection since you can't imagine evading tax and would like to see that evading tax didn't pay.

Anyone asking a criminal about to commit a crime if he thinks he'll get caught will always get a negative answer, in principle. A person planning to commit a crime isn't counting on getting caught, because then they wouldn't commit the crime. This is partly about calculation and partly about rationalising your own behaviour.

The latter explanation is possibly supported by the circumstance that there is no correlation between actual risk of detection and perceived risk of detection. The people who perceive the highest risk of detection are older women<sup>13</sup>, and they are not the group most subject to enforcement.

It is entirely possible, in other words, for the will to do the right thing to increase at the same time as perceived risk increases, without this implying that the deterrent effect of enforcement has increased. In these cases, the perceived risk of detection is the result of the behaviour, not its cause. If that is so, it means that the perceived risk of detection is an excellent indicator of actual behaviour.

## 4 The importance of the environment

As described above, the effects of enforcement are greatly influenced by how the individual perceives enforcement and in what context enforcement is carried out. The circumstances and surrounding environment are significant.

### 4.1 Context and perceptions matter

People do not behave strictly rationally, as classical economic theory has it. People are influenced by situations and by how choices are presented or perceived. Behavioural economics points to several different peculiarities in humans. One of these is loss aversion, which implies that we humans dislike losses more than we like gains. Most of us are prepared to take considerable risks in order to avoid a loss, but are not equally prepared to take considerable risks in order to guarantee a gain.

A good example of this has to do with people who misrepresent deductions under 'employment income' on their tax returns. People whose preliminary tax assessment includes excess tax are less inclined to fiddle deductions (they don't want to take any risks that could threaten their gain, i.e. the refund). People with tax arrears are therefore more inclined to fiddle deductions (they are prepared to take a risk to avoid the loss).<sup>14</sup>

Let's assume that Karl and Per, who are twins, each run their own business. Karl's business is profitable, and he has never evaded taxes. Suddenly and unforeseeably he loses several of

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<sup>13</sup> Skatteverkets medborgarundersökning 2012, Rapport 2012:1.

<sup>14</sup> Per Engström, Katarina Nordblom, Henry Ohlson and Annika Persson, "Loss evasion and tax aversion", Uppsala Center for Fiscal Studies, Working paper 2011:11.

his clients, and his business begins to go very badly. In order to try to rescue his and his family's livelihood, he begins to evade taxes. Karl has gone from being disinclined to evade taxes to being inclined to do so. His brother Per has long had problems with his business and has also been evading taxes for a long time. Suddenly his business begins to do well, and in order not to risk his profits, he stops evading taxes. Per has gone from being inclined to evade taxes to being disinclined to do so. Have Per's or Karl's personalities or morals changed? Probably not – their changed behaviour can be explained by changed circumstances. The environment in which a person acts is very significant for his or her behaviour.

Karl's and Per's sister, Stina, also runs her own business. It has always done well, and makes big profits, but Stina has evaded taxes all along, and also tends to evade more taxes when profits increase. Why is that? Is she not affected by loss aversion? In fact she is affected by loss aversion, but her calculation is different. What constitutes a loss is determined on the basis of a reference point. If you are expecting a profit of 100, but it only reaches 50, that can be seen as a loss. The reference point is usually the present situation, but it can also be an expectation. Stina sees the entire profit as a gain, and she sees taxes as a reduction of that gain. This reduction is a loss, and she thus becomes inclined to take risks in order to avoid this loss. This has to do with mental accounting, which is another essential part of behavioural economics.

All people practice mental accounting, which means that you perceive different money in different ways. An unexpected income can be perceived as totally different to an expected income, and is therefore spent in a different way (perhaps on something unnecessary or futile). A person might divide their salary into different parts – net earnings and available balance after housing costs, for example. This can be done by keeping written accounts or by using different bank accounts, or it can be done only in your head.

The point is that if Stina had discounted tax from profits in her mental accounting, she would not perceive the tax as a loss. How you present things to yourself or others becomes significant for behaviour. This also makes it difficult to understand behaviour and to find typical behaviours.

Loss aversion also means that early enforcement probably works better than enforcement which is applied when tax evasion has been going on for a long time. A person who is evading taxes for the first time perceives the reduced tax as a gain, and is not willing to take big risks. Enforcement can then make the person change their mind. If tax evasion has been going on for a long time, the reference point will be evaded taxes, in which case stopping would be perceived as a loss. In that situation, a tax evader is prepared to take considerable risks in order to avoid the loss. Enforcement is then unlikely to change the person's

behaviour, and could even make their tax evasion more serious in the future (as compensation for the tax that was the result of enforcement).

Enforcement can thus have different effects depending on when it is carried out. But once again there are no guarantees – instead it's a matter of the likelihood of an individual prevention effect increasing when enforcement occurs early.

The above also points to the difficulties in trying to evaluate the risk profile of individuals. Different individuals may of course have different characteristics and moral values, but contexts and how those contexts are perceived are probably more significant. Even if we know an individual's characteristics and attitudes, we cannot know how that person is going to perceive a given context. To try to make assessments of individual taxpayers seems rather meaningless – a better idea would be to make probability assessments based on external, actual circumstances.

## 4.2 How we frame taxes matter

Dan Ariely, a psychologist who has written several books about behavioural economics, points out that people behave very differently depending on how a situation is perceived or presented – what is called *framing*.

Ariely argues that people can make decisions based on social norms or on economic market norms. He illustrates this with the results of a study in which lawyers were asked if they were willing to take on a few cases involving people of small means, at a lower fee (\$30 per hour). Most of them said no. The researchers then asked lawyers if they would be willing to take on a few cases involving people of small means free of charge. Now most of them said yes. When money was involved, the lawyers assessed the request on the basis of economic considerations, and then \$30 was too low a fee. When money was not involved, they assessed the request on the basis of social considerations, where norms say that it is right to help others.

A decision to do (or not do) something can thus be made by applying two different yardsticks – one of social norms and the other of economic benefit. According to Ariely, it is enough just to mention money for the economic yardstick to be applied. His conclusion is that money is the most expensive way of motivating people to do something. Social norms are both cheaper and more effective.

Ariely does not refer to taxes specifically, but mentions that the social contract that exists between citizens and state could be endangered if it is valued exclusively in monetary terms.<sup>15</sup>

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<sup>15</sup> Dan Ariely, 2008, "Predictably Irrational – The Hidden Forces that Shape our decisions".

In other words there may be advantages to seeing taxes as a social transaction (even if taxes undoubtedly have to do with money). Without it having been expressly stated, or even fully realised, this is actually what the Swedish Tax Agency's strategy is trying to do.

## 5 Different types of preventive effect

Enforcement can produce both individual prevention (effects on those subject to enforcement) and general prevention (effects on those not subject to enforcement). These effects are different and can be expected to occur in different ways.

### 5.1 Different effects depending on the type of error

An increased understanding of how the preventive effects work can be gained by looking at a couple of diagrams. The one below shows how errors (both unintentional and intentional) are distributed between small and large errors.<sup>16</sup>

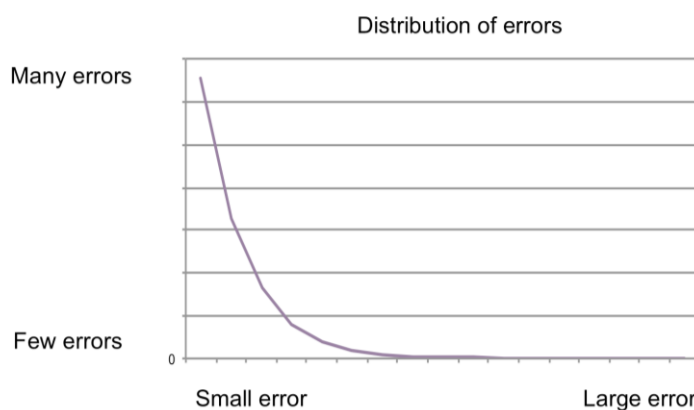


Figure 6. Diagram of how the number of errors are distributed between small and large errors.

There are, quite simply, many small errors and few large errors. This is entirely natural. A person handling large sums is probably more careful, meaning that fewer unintentional errors occur. There are probably more people who accept small errors. As for intentional tax evasion, it's also natural that fewer people are prepared to fiddle large sums, partly because they aren't prepared to take the increased risk and partly because fiddling large sums requires a large income to begin with.

The report 'Right from the start'<sup>17</sup> also noted that the development of tax evasion for a given tax evading individual should look something like this:

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<sup>16</sup> This was studied e.g. by the Swedish National Audit Office in 1997, 'Skattekontrollen och pengarna' ('Tax enforcement and money'), Report 1997:7.

<sup>17</sup> RSV Report 2005:1, 'Right from the start'.



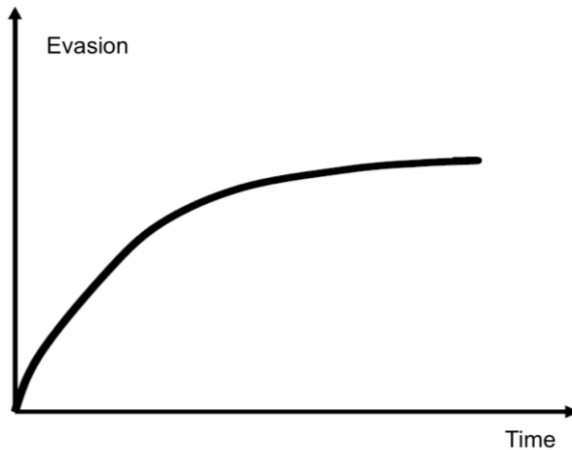


Figure 7. Development of tax evasion over time for an individual.

A person who begins to evade tax is likely to do so with a relatively small sum (which is seen as a gain, and therefore the person is risk averse). When tax evasion has gone on for some time, this sum will no longer be seen as a gain, since it's being taken for granted (and not as something extra). This can lead the person to become prepared to take bigger risks and evade more tax, but only up to a certain limit. This limit is entirely individual, and depends on the person's possibilities for evading tax and their willingness to take risks. In other words it is not the case that every person who starts evading tax ends up a big-time tax fiddler; instead, most people fiddle relatively small sums.

Early tax evasion thus tends to involve small amounts (which is not to say that all small sums fiddled are examples of early tax evasion). As noted earlier, the individual prevention effect may be expected to be bigger when enforcement targets early tax evasion.

It follows that the individual prevention effect is smaller when tax evasion has been going on for a long time. This longer term tax evasion also tends to involve larger sums, though this need not be the case.

It is reasonable to assume that the opposite applies for general prevention effects. They should be greater when enforcement targets serious and big errors. Enforcement should be perceived as more legitimate when it manages to deal with large scale and serious tax evasion instead of only dealing with minor tax evasion. In this context, 'general prevention effect' refers to the norm reinforcing effect and not to a generally deterrent effect.

The conclusion is that enforcement works best for early errors (often small and common errors) by means of a big individual prevention effect, and for serious tax evasion (often big and unusual errors) by means of big general prevention effect.

What this implies is that enforcement works badly for everything in between – for errors which are not early and which are not serious tax evasion either. This makes both the

individual prevention effect and the general prevention effect small. In other words there are few gains to be made from targeting minor tax evasion, through enforcement, which has been going on for a long time.

## 5.2 The general prevention effect is most important

Another conclusion that can be drawn from the reasoning above is that it's difficult to maximise individual and general prevention effects at the same time. They require different things to be enforced. But the two types of effect are not necessarily mutually exclusive – they can be combined, but the more effort you put into increasing general prevention effects, the less room you leave for individual prevention effects, and vice versa. A functional strategy should choose one type of effect as the principal one and, given that choice, do as well as possible with the other type.

There is much to suggest that the general prevention effect, in the form of norm reinforcement, is the most important one. It affects all taxpayers in some way, and is thus cost effective. The individual prevention effect assumes a one-to-one relation, and is thus more costly. Successful general prevention makes it possible to achieve a high level of compliance with relatively few enforcement actions. The overall effect thus ought to be considerably greater than for individual prevention.

This should not mean, however, that the individual prevention effect should be ignored. When enforcement is carried out in order to achieve general prevention effects, efforts should be made at the same time to try to achieve the best possible individual prevention effect. It is furthermore likely that a smaller part of enforcement will need to be spent on actions aimed primarily at individual prevention effects in order to obtain good overall enforcement that is seen to be legitimate and credible in its entirety.

Still, focusing specifically on general prevention effects will have consequences for how enforcement is prioritised and how effects are evaluated. In other words, what should be regarded as most important are the effects on the whole (the overall 'system'), while the effects on those actually subject to enforcement should be secondary (but not unimportant).

Enforcement is often directed towards a specific type of error, occurrence, or group of taxpayers. This need not be wrong at all, but the interesting question is where the effect is expected to occur.

Studies in the US have shown that taxpayers who were given information via the media fiddled less than if they had received information from the people around them. The reason for this is thought to be that friends and acquaintances only tell you about enforcement when the authorities have failed to identify tax evasion, or when your acquaintance feels

unfairly treated. A person who has been subjected to enforcement and has been found guilty of tax evasion may well be disinclined to tell you about it.<sup>18</sup>

However, an enforcement action directed at a certain type of occurrence, e.g. unreported earnings, could potentially have some effect for that type of occurrence specifically. Enforcement directed at a specific industry could also have an effect on that particular industry. But that is based on enforcement being communicated (preferably in advance) – and then it is the information as such that has an effect. Of course, enforcement then has to happen in reality. But as long as an enforcement action takes place, it doesn't matter how the tax authority defines the group subject to enforcement, e.g. as 'unreported earnings', 'cash industries', 'taxi' or anything else. The effect occurs as a result of enforcement and communication being combined.

Communication is what creates the direct effects. But communication is of course reliant on enforcement being carried out. Communication can occur both before and after enforcement has been carried out.

However, communication must not give the impression that tax evasion is widespread, because then tax evasion will increase. There are studies which show that reports about tax evasion generally reduce the will to comply, but if the reporting concerns specific and delimited tax evasion (a certain group or individual), the same negative effect does not occur.<sup>19</sup>

## **6 Better understanding by using a system approach**

We have noted, then, that the effects of enforcement can vary due to a number of different factors, making it difficult to control and predict these effects. The effects of enforcement cannot be understood in terms of simple and linear causal links – it is not the case that enforcement X always leads to effect Y, and the more X you apply the more Y you get. Such lines of reasoning and assumptions are outright wrong. Instead it is a question of seeing the effects of enforcement as part of a complex system. The causal links are dynamic, i.e. non-linear and variable over time. Just because X leads to Y today, it need not do so tomorrow.

### **6.1 Enforcement as part of a complex system**

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<sup>18</sup> Leandra Lederman, 2003, "The Interplay Between Norms and Enforcement in Tax Compliance".

<sup>19</sup> Ibid.

One researcher who has tried to analyse the issue of the effect of enforcement on taxpayers' behaviour is Jack Manhire, who previously worked at the American tax authority (IRS).<sup>20 21</sup> He advocates a system approach in order to better understand the effects.

Manhire points out that studies of the effects of enforcement normally involve assessing the effect of variations in enforcement frequency and sanctions on individual taxpayers' motivation and behaviour. As described above, these studies do not provide any unequivocal answers.

This is what may be expected of a complex system. If you apply a system approach, it is not possible to understand the effect on the whole (at the macro level) by studying behaviour at the micro level, regardless of how detailed and extensive the studies are, and regardless of how many factors you include in the assessments.

A traditionally reductionist approach in which you try to understand the whole by analysing the parts doesn't work. But it is possible to understand the system as a whole. Complex systems can be governed by simple rules and still present an unexpected and unpredictable behaviour.

In order to test these ideas, Manhire builds a mathematical model with simple rules governing taxpayers' and the tax administration's behaviour. These rules are based on various research findings about taxpayers' motivation. The model should not be seen as a description of reality, however, and doesn't show how taxpayers actually behave. The purpose of the model is to examine whether simple rules for behaviour at the micro level can lead to unexpected or unpredictable effects at the macro level.

The results indicate that behaviour at the macro level is fairly stable, while behaviour at the micro level can be variable. When the share of the total population that is subject to enforcement is set at 0.88 per cent, the degree of compliance becomes 82 per cent, which closely matches actual conditions in the US. When the enforcement frequency is increased or reduced in the model, it has no effect whatsoever on the overall degree of compliance. By contrast, the behaviour of individual taxpayers is influenced by the enforcement frequency, but in different ways (some comply more and others less), and the net effect is low or none at all.

Behaviour at the macro level, however, is influenced by the perceived strength of the tax authority – which is distinct from the perceived risk of detection or enforcement frequency. The actual enforcement frequency may be connected with the perceived strength of the tax

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<sup>20</sup> J. T. Manhire, "There is no spoon: Reconsidering the tax compliance puzzle", Treasury Executive Institute - U.S. Department of the Treasury, 2014.

<sup>21</sup> J. T. Manhire, "Do Audits Matter?: A Parallax Theory of the Relation between Tax Enforcement and Underreporting", Treasury Executive Institute - U.S. Department of the Treasury, 2015.

authority, but need not be. Manhire's view is that we should perhaps not attach so much importance to the perceived risk of detection when assessing the effects of enforcement on the system as a whole.

It is important to underline that this model doesn't prove anything about how these things work in reality. What the model does is showing that it is possible that behaviour at the micro level cannot be aggregated to the macro level. Manhire points out that a factor which applies for the population as a whole, e.g. the perceived strength of the tax authority, can have a greater significance than factors related to individuals' behaviour. He further points out that since it is a mathematical model, you can choose what label to apply to the factor which applies for the population as a whole (perceived strength of the tax authority). This factor could just as well be called 'shared social norms' or 'shared sense of compliance as a moral duty', or something else that can apply for the system as a whole. The lesson here is that system factors play a bigger role than individual-related factors.

Even if this is only a theoretical example, it shows that there can be advantages in trying to understand taxpayers' behaviour and the effect of enforcement as a complex (adaptive) system. This means that it is possible to achieve some understanding of how the system as a whole works, but that it probably isn't fruitful to try to elucidate detailed connections between a number of different factors.

## 6.2 Complex adaptive systems are not complicated

Complex adaptive systems have the following characteristics:

- They consist of many independent integral units, e.g. a human community or the living cell.
- The interaction leads to spontaneous self-organisation, e.g. birds adapting to other birds and thus creating a flock.
- They are adaptive, trying to turn occurrences in their surroundings into advantages, e.g. a species that evolves towards a better adaptation to its surroundings or a company that learns from its experiences.

Such complex, self-organising and adaptive systems have a dynamic that distinguishes them from static objects, e.g. computers, which are merely complicated and not complex. Complex systems are more spontaneous, less ordered and more alive.

In order for a system to be considered a complex adaptive system, it should possess all or some of the following attributes:

- The system has many parts and many connections between its parts.
- The system has a memory or includes feedback.

- The system can adapt in accordance with its history or feedback.
- Relations between the system and its surroundings are non-linear.
- The system can be influenced by, or can adapt to, its surroundings.

Complex systems are thus systems in which the parts interact, e.g. like the pupils in a classroom or persons in a working group. Their results are emergent, i.e. they arise from simultaneous interaction rather than as a result of the various stations along a conveyor belt.

We don't know what will emerge from a complex system at any given time, but in retrospect we can point to which interdependences led to a specific result. This means that a complex system cannot be controlled. But it can be influenced.<sup>22</sup>

People interacting with each other, and with government authorities and the media, are a typical example of a complex adaptive system. The influence of enforcement on behaviour is therefore more easily understood if it is regarded as a complex adaptive system.

## 7 How to improve the effect of enforcement

The above description on findings from research and experience point to a number of factors that are important for improving the effect of enforcement. Here is the assumption that enforcement is used for increasing the willingness to comply and for the purpose of deterrence.

### 7.1 Use enforcement to strengthen social norms

Social norms can be seen as the values of a certain social group. Personal norms are your own ethical values and moral convictions. Personal norms exist at different levels, in the form of very fundamental values that are innate or learned early in life and other, more superficial ones that can change throughout your life.

Fundamental values can be such things as feeling an aversion to injustice, and wanting to be popular by doing things that others appreciate. There are other primates than humans that feel an aversion to injustice. A study at the Primate Research Centre in Atlanta showed that apes rejected food (i.e. harmed themselves) when they saw that another ape received better food under the same circumstances.<sup>23</sup>

More superficial values can include finding it cool to smoke, or choosing to become a vegetarian for ethical reasons. These values can be influenced by the individual's world view changing through new knowledge, e.g. that you learn more about the conditions for animals

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<sup>22</sup> Anders Ekholm, from the anthology 'Om Sverige i framtiden – en antologi om digitaliseringens möjligheter' ('On Sweden in the future - an anthology about the possibilities of digitalisation'), an interim report by the Digitalisation Commission, SOU 2015:65.

<sup>23</sup> RSV Rapport 2005:1, "Rätt från början".

or the effects of smoking. New knowledge will not change your fundamental values, such as the will to do the right thing or to be popular, but your attitude to e g smoking can be changed.<sup>24</sup>

Social norms are about wanting to do what others do, and what others think is right. This is basic human behaviour, and difficult to change. But perceptions of what others do and what others think can change over time, and thus behaviour can too.

We humans simply want to do what others do and be popular. But who these ‘others’ are is important. We only become influenced by social norms in groups that we ourselves identify with. Social norms in other groups have no significance for our own behaviour. A person can identify with a number of different groups at the same time – such as ‘we who were born in the 60s’, ‘we Stockholmers’, ‘we women’ or ‘we golfers’. The psychologist Robert Cialdini<sup>25</sup> points out that certain groups have a greater influence on us than others:

- *Significant others.* People you look up to, regardless of whether they are people you know or various types of idols.
- *Many others.* When very many feel and act in a certain way.
- *Similar others.* People who resemble you in some way, i e someone you can identify with.

When communicating about what others do and think it is important to specify who thinks what. Sometimes it can be better to try to include everyone, ‘everyone who lives and works in Sweden’, and sometimes it can be better to describe something much more specific, such as ‘people who live in Sundbyberg’.

Studies carried out in Australia and in the US show that norms are significant and that they can be influenced. In Australia, a group of taxpayers received information about the result of a survey. This information emphasised that the survey showed that there was a difference between what most people think and what they believe others think. Most people think you should pay taxes, but many people believe that others don’t think so. The result was that the degree of voluntary participation was higher in the group that had been told the result of the survey than among other groups.

A similar study was carried out in the US. A group of taxpayers received a letter with the following content:

*According to a questionnaire survey, many people believe that others evade their taxes. This is not true, however. Controls carried out show that those who file tax returns provide correct information and pay 93%*

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<sup>24</sup> RSV Rapport 2006:6, ”Strategier och strategiskt tänkande”.

<sup>25</sup> Robert Cialdini, 2001, ”Influence Science and Practice”, 4th ed., Allyn & Bacon, Boston.

*of the correct tax. Most people file correct tax returns before the deadline. Even if some taxpayers should pay more than they do because of minor mistakes, the number of people who intentionally evade taxes and who represent the greater part of the tax gap is small.*

The letter had a positive effect on the degree of compliance. A different group of taxpayers received another letter, which contained rational arguments. It described what the taxes were used for and how society suffers if you don't pay. That letter had no effect.<sup>26</sup>

In the cases described, communication didn't change people's personal norms. The letters described the norms that actually exist, and most people want to follow the social norms. In other words, this is about giving people knowledge that makes them change their world view and thus their attitude and their behaviour (but not their own values).

Social norms can also change over time. People's ideas of what is right and wrong change. An oft-cited example is Sweden's law against beating children, which was introduced in 1979. This law contributed to influencing norms, leading increasing numbers of people to regard it as wrong to beat children. In any society, social norms are always evolving, often from the perspective of what the world looks like and what issues are being discussed (for example, attitudes to environmental concerns and things like waste separation have probably evolved gradually).

Social norms in one group influence the behaviour of people who identify with that group. Such adaptation is not the result of group pressure – instead it's a question of a process in which the norms are internalised by the individual and become a genuine part of that person's values.<sup>27</sup>

Tax enforcement influences social norms both by strengthening people in their view that others are doing the right thing since evading tax doesn't pay, and by signalling that evading tax is wrong. Enforcement can also provide knowledge about how much tax evasion occurs, which in turn can be communicated. As mentioned above, people tend to believe that tax evasion is more common than it actually is, and by telling them how things are, their behaviour can be influenced. As social norms against tax evasion are strengthened, they will gradually be internalised by individuals as personal norms. When this happens, behaviour will also be influenced since anyone who breaks their own personal norm will suffer from feelings of guilt and shame. These are feelings that we humans are able to anticipate, and therefore we refrain from doing things that bring such feelings on.

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<sup>26</sup> RSV Rapport 2005:1, "Rätt från början".

<sup>27</sup> Michael Wenzel, 2002, '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>



## 7.2 Make sure the enforcement is legitimate...

It has been noted above that enforcement must be perceived as legitimate and fair in order to increase the will to do the right thing, and that it must support social norms by persuading people that others will do the right thing and that this really is the right thing to do.

Enforcement must therefore be perceived as credible, and sanctions as just. Too little enforcement leads people to doubt that others are doing the right thing, which erodes trust in enforcement. Too much enforcement, on the other hand, leads to perceptions of coercion and threats, which undermines legitimacy. In other words, enforcement must be sufficient – neither too limited nor too extensive in scope. It has to be just right, or ‘lagom’ as we say in Swedish.

It is impossible to establish limits for what is just right in terms of the scope of enforcement – in theory as well as in practice. The limits are variable. What types of enforcement are carried out and how it is carried out are also of considerable significance. The crucial element is that enforcement is seen as a means and not as an end in itself.

There is probably quite a wide span between the minimum level of sufficient enforcement and enforcement that is too extensive. Variations in enforcement frequency between these limits can directly affect prevention in individual cases, but can only indirectly affect general prevention.

It could be the case, for example, that the general public or various industry representatives feel in a given context that for a certain group of taxpayers there should at least be N number of enforcement actions. In that situation it may be – but need not be – a good idea to carry out precisely N number of enforcement actions, as this will have a bearing on the credibility and legitimacy of enforcement. It is all about perceptions of credibility and legitimacy (which of course have to be based on a true picture of reality). Such considerations naturally need to be combined with other factors that may affect legitimacy.

In a review of various studies Richard Lavoie, a researcher, was not able to establish any correlation between actual levels of enforcement and the degree of compliance.<sup>28</sup> Researchers in the US have also examined the connection between the actual level of enforcement and taxpayers’ perception of enforcement frequency. They found no connection whatsoever.<sup>29</sup> This lends support to the notion that enforcement mainly works indirectly, by strengthening general prevention. Qualitative factors such as who is the subject of enforcement, how it is done and how enforcement is communicated are decisive for the effect that can be achieved.

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<sup>28</sup> Richard Lavoie, 2008, “Cultivating A Compliance Culture: An Alternative Approach For Addressing The Tax Gap”.

<sup>29</sup> Andreoni, Erard, Feinstein, 1998, “Tax Compliance”. Journal of Economic Literature, Vol XXXVI, June 1998.

It is important to remember, however, that enforcement will always produce both positive and negative effects in terms of individual prevention. In other words enforcement will sometimes lead to reduced tax evasion and sometimes to increased tax evasion. It is hard to predict which outcome it will be, and the tax authority can only influence the likelihood of a positive outcome – not guarantee a certain outcome. But provided that the net result is positive, there are gains to be made from carrying out more enforcement actions – albeit not to such an extent that enforcement begins to lose its legitimacy in the public perception.

Still, as noted above, it can be difficult to maximise both general and individual prevention in one and the same enforcement action. Thus enforcement should ideally maximise general prevention effects while at the same time providing sufficient individual prevention effects.

### **7.3 ...and treat people with respect**

The importance of perception was demonstrated in a survey carried out by the Swedish Tax Agency in 2008 about how enforcement influences trust in the Swedish Tax Agency.

Among businesses, 15 per cent felt increased trust and 17 per cent felt decreased trust following an audit. Those who responded that their trust had increased or decreased were also asked ‘What is the principal reason that your level of trust has changed?’ without a choice of fixed responses. The open responses to this question showed that a positive reception was the predominant reason for increased trust, followed by helpfulness, competence and good communication. For reduced trust as well, reception and treatment, i.e. ‘bad reception’ was the most common reason, but almost the same number of responses indicated dissatisfaction with ‘incorrect assessments’.

An analysis of the connection between the statements with fixed responses and the question whether trust had increased or decreased provides a similar picture of which factors influence trust. The change in trust has a strong correlation with the statement ‘I was well received’, but an even slightly stronger correlation with the statement ‘I feel that I was treated fairly’.

Whether the change was positive or negative appears to play quite an important role, but the correlation between changes in trust and the size of the reassessment was very weak. It simply seems to be the case that there are other factors than the direct output from enforcement which are more important for a change in trust.

The conclusion is that the most important factor for increasing trust among those who have been the subject of enforcement is to create a good dialogue in which we listen to their arguments – so that they feel fairly treated.<sup>30</sup>

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<sup>30</sup> The Swedish Tax Agency, Analysis Unit, memorandum – The Enforcement Survey, 11 June 2008, Henrik Franzon.

Naturally, people's experiences are subjective. Different people can perceive the same enforcement action in completely different ways, and can experience similar treatment in different ways. A tax authority can never know in advance how someone is going to perceive an enforcement action. The effect of a given enforcement action is thus difficult to predict. What can be established is that a good reception and a well-executed enforcement action (correct, fair and impartial) increases the likelihood that enforcement will be perceived as legitimate and that it therefore contributes to increasing trust and strengthening the will to do the right thing. But there are no guarantees and no definitive causal links.

#### **7.4 Focus on what people do, not on how they are**

People's values and motives influence behaviour, but they do so in interaction with the environment and the circumstances. It is very difficult for a tax authority to identify people's motives and directly influence them by influencing each individual person.

Segmentation or profiling based on motives, values, or on how people are, should therefore be avoided. Aside from the difficulties in identifying causal links, this has to do with trust in the authority. Using people's characteristics as a starting point means that prejudices easily come into play, and that isn't ethically defensible (or effective). The following can serve to clarify this.

Which, if any, of the following characteristics should a tax authority use in selecting individuals for enforcement: gender, age, place of residence, national origin, or sexual orientation? The Swedish Tax Agency has access to information about gender and age through the personal identity number, and also has information about citizenship that could be used as an indicator of origin. Other approximate indicators may be possible to obtain by combining information which is already available, e.g. to see if people of the same gender are registered at the same address. The question, then, is whether any of these characteristics should be used in making the selection. Is it OK, for instance, to use gender and age for selections, but not national origin? If so, why? Where do you draw the line? Even if one or more of these characteristics can be shown to be significant, and even if some are more sensitive than others, the Swedish Tax Agency refrain from all assessments along these lines, for ethical reasons.

The Swedish Tax Agency can thus make it very clear that selections will never use the grounds for discrimination enumerated in the Instrument of Government (Ch 1, Section 2): *'Public institutions shall combat discrimination of persons on grounds of gender, colour, national or ethnic origin, linguistic or religious affiliation, functional disability, sexual orientation, age or other circumstance affecting the individual.'*

This can serve to make selection more dependent on events and on what people do, which can hopefully lead to greater accuracy (and, for instance, that men are selected more often

because they make more errors, not because they are men). When the Swedish Tax Agency carries out analyses to describe what reality looks like, there is of course nothing to stop it including different variables such as age and gender – because that is simply a matter of description and not of selection.

## 7.5 Sanction the act, not the person

How a sanction is imposed on or presented to the individual subject to it can be significant for the way that individual is influenced by the sanction. The sanction should be perceived as fair, and should be imposed by means of a process characterised by procedural justice. In addition to this, the researcher John Braithwaite has pointed out, the sanction must help the individual return to honest behaviour – he calls this ‘reintegrative shaming’.

A person who has committed a crime and who is punished for it is subjected to the disapproval of those around him and of society as a whole. This disapproval can lead to the criminal having feelings of guilt and shame. How this disapproval is presented or perceived can influence whether the feelings of guilt and shame lead to an increased or decreased inclination to commit further crimes.

Society’s disapproval can be either stigmatising or ‘reintegrative’. The former has a negative effect on behaviour, the latter a positive effect. The difference lies mostly in what is being punished – the person or the act. If the person is punished, this is perceived as stigmatising, but if instead it is the act that is punished and the person is treated with respect, the person will be able to deal more easily with the punishment and the shame that follows from it.<sup>31</sup>

In other words, sanctions should preferably not be perceived as ‘Since you are a tax evader you are being punished’, but rather as ‘Your criminal act is being punished’.

This is actually quite natural and human. All expressions of disapproval (including legal sanctions) can provoke anger if they are presented in a disrespectful way. This leads to a sense of pride in what one has done. The behaviour becomes defiant.

Sanctions and expressions of disapproval that signal ‘You are a bad person’ are a blow to the sanctioned person’s self-respect. In order to avoid this negative feeling, blame is instead shifted to whoever imposed the sanction. That way, they see themselves as a victim, which makes it right to defy authority and be a rebel instead. Instead of seeing themselves as a failure, they choose to see themselves as a hero, which is of course positive for their self-respect. Continuing to defy authority becomes a confirmation of the role as hero. And therefore the inclination to commit crimes increases.

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<sup>31</sup> Jennifer Mongold & Bradley Edwards, “Reintegrative Shaming: Theory into Practice”. *Journal of Theoretical & Philosophical Criminology*, September 2014.

If sanctions can be imposed in a way that the perpetrator perceives as legitimate, fair and respectful, they are more likely to have a positive effect. Thus sanctions need to be imposed in a way that allows the perpetrator's self-respect to be preserved, i.e. by signalling 'What you did was wrong' without therefore implying that there is something wrong with the person.<sup>32</sup>

## 7.6 Also use system-level measures

Increasing the focus on other system-level measures than enforcement has been a clear trend recently. Here, 'system-level measures' does not refer to IT systems but to measures that affect structures, circumstances and the surrounding environment. It is also about measures that work one-to-many. System-level measures can therefore be very cost effective. However, this often requires that the system-level measures are combined with e.g. enforcement.

### Cooperative compliance

Enhanced cooperation between the tax administration, the taxpayers and their representatives is becoming more common in many countries. Such programmes are often called cooperative compliance programmes and can involve large businesses or tax advisers, for example. The basic idea is that taxpayers can achieve greater certainty if they are more transparent about tax issues and tax risks. If these issues or risks can be resolved before tax returns are filed, there are opportunities for improved effectiveness for both taxpayers and tax administrations. The purpose is to get things right from the start.

This will affect enforcement strategies because less enforcement, or better targeted enforcement, will result from the tax administration having a better understanding of the risks of mistakes or tax evasion.

### Tax compliance by design

Another system-level measure deals with digitalised information chains as a way of achieving tax compliance by design.<sup>33</sup> The idea is for companies' business transactions to be handled digitally and automatically to the greatest extent possible, and that tax returns and other information be produced automatically whenever possible and sent to the tax authority (and possibly to other authorities) straight from the companies' business administration systems. This should make it easy to get everything right and hard to get anything wrong, and so lead to fewer errors.

This changes the circumstances for enforcement. With this system, there is no reason to audit individual transactions or items in the tax return. Instead there are two questions that

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<sup>32</sup> RSV Report 2005:1, "Getting it right from the start".

<sup>33</sup> These ideas are in line with the suggestions in the OECD report 'Tax Compliance by Design – Achieving Improved SME Compliance by Adopting a System Perspective', published in 2014. <http://www.oecd.org/tax/administration/tax-compliance-by-design-9789264223219-en.htm>

must be answered: 1) do these information chains work in the intended way, i.e. is all the information handled correctly? and 2) are there any transactions which are not included in these chains and are therefore not correctly reported in the tax return?

If the information chains are working there is no reason to check the information handled by them. Anyone who wants to evade taxes will instead ensure that they keep the information completely outside of these automated and digitalised information chains. This places two completely different demands on enforcement.

To see if the information chains are working, some form of random check is needed. This can be done either by following a number of transactions right through the system and ensuring that they are handled correctly, or by noting what information goes into the chains and comparing with what comes out in the form of tax returns etc. The chains are thus regarded as 'black boxes' – you don't need to know what happens inside them as long as the result is correct.

It is likely that both methods will need to be used. But the point is that these methods of enforcement should be considerably less resource intensive than traditional enforcement through audits. Single random checks will show if the system works, and if it does, we can be sure that what is being transmitted by the chains is correctly reported. Here, too, a random sample will be required in order to get a correct picture of how the chains are working (but it will be limited in scope).

The situation is completely different for the enforcement needed to see if information is being concealed and handled outside of the digital information chains, i.e. intentional tax evasion. This will require access to third party information and smart investigation methods. What is clear, however, is that the filed tax return will be of limited value to this type of enforcement. The tax return will be correct based on the information available in the reporting system, and will probably not reveal what information has gone unreported. Instead this will involve looking at the company's activity, its clients and suppliers, cash flows and other information, in order to find clues. This is demanding detective work.

But the advantage of the digitalised information chains is that only a very small proportion of enforcement resources need to be spent on the greater part of companies, while more resources can be spent on finding intentional and serious tax evasion. That, however, cannot be done in the traditional way, by waiting for tax returns to be filed and then finding irregularities by examining them. Tax returns are of course relevant, but tax evasion should be sought out continuously, with no concern for tax return times. Here, too, it will be a matter of taking circumstances and environment into account. What circumstances and what environments make it possible or probable that tax evasion will occur?

## 7.7 Be creative

'Superfreakonomics', the best-selling book by Steven Levitt and Stephen Dubner, was published with the following cover.

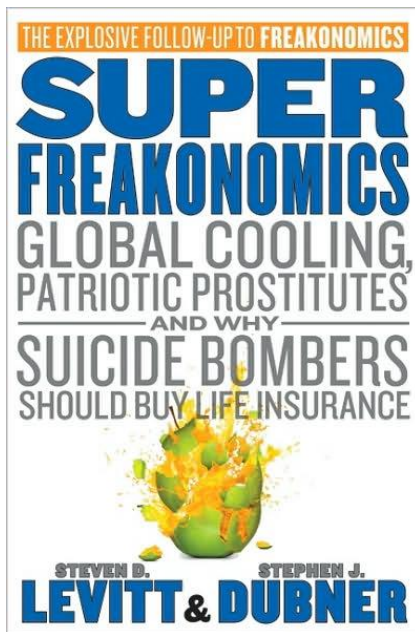


Figure 8. The cover of 'Superfreakonomics', published 2009.

Already on the cover we're told that suicide bombers should buy life insurance. In the book this is explained as follows: The authorities are using an algorithm to find potential terrorists. This algorithm looks at a person's bank account movements, e.g. to see if there are no regular salary deposits but rather one large deposit and irregular withdrawals, and it also considers that fact that suicide bombers don't normally take out life insurance (the policy would be invalidated). So it might be a good idea to take out a life insurance policy just to avoid discovery, the authors suggest.

When the book came out, this of course became the subject of fierce debate. The authors were accused of helping terrorists and criticised for explaining how the algorithm worked. The authors were forced to admit, shamefacedly, that they hadn't thought about that, but said they didn't think it would make any difference.

But in Levitt's and Dubner's most recent book, 'Think Like a Freak', published in 2014, they tell the whole story. The problem was that the authorities' algorithms for identifying terrorists weren't accurate enough. People make all sorts of bank deposits and withdrawals for different reasons, and not everyone has a life insurance policy. To improve the algorithm's accuracy, the book made a big deal of suggesting that suicide bombers should buy life insurance – and immediately produced a new indication that someone might be

suspect (if they matched the profile on other counts, and then also took out life insurance shortly after the book had been published). In other words the whole thing was a collaboration between the authors and the intelligence services, with the aim of tricking terrorists into revealing themselves. Whether the ruse worked or not is of course secret – but it's nevertheless easy to appreciate the cleverness of the setup. It did not amount to entrapment, since it only involved getting suspected terrorists to take out life insurance and thereby reveal themselves. Instead of only using the data that was available, they tried to find ways of producing new data. That is both proactive and creative.

In their new book Levitt and Dubner also explain why senders of what are known as Nigerian letters reveal that they are from Nigeria, when it is common knowledge that these letters are a scam. The reason is that the scammers want to sift the wheat from the chaff. These letters are sent electronically in large numbers, which doesn't cost very much. But when someone replies, a certain amount of manual administration is required in order to complete the fraud (getting someone to pay money). The scammers don't want to waste their time on the sort of people who will soon realise that it's a scam. Instead they want to find the most gullible and ignorant people – that is, those who don't know about Nigerian letters, or what they mean, in the first place. So they send many letters, and almost all recipients realise that it's a scam – but those who don't are very likely to be defrauded. Clever thinking by the scammers. However, efforts are being made to thwart this with similar methods. There are people who have devised software programs that reply to these emails in such a way that the scammers think that it's a real (gullible) person who has swallowed the bait. A correspondence thus begins that requires time and effort by the scammers, but which will not lead anywhere. This increases the scammers' costs and reduces their returns. Smart.

These are examples of creative thinking, and they show that there are always new possibilities and smart solutions which are both effective and cheap. For a government authority like the Swedish Tax Agency it is of course important that all measures taken are both legally and morally defensible. The Swedish Tax Agency can't start deceiving people, even if its aims are honourable. Still, that doesn't mean that we have to shut the door on new and creative thinking.

There is always a risk that enforcement (as with other measures) ends up in a rut, and that new possibilities are therefore missed. The Swedish Tax Agency's enforcement has traditionally applied the following procedure: tax returns received – selection – investigation. The developments that have happened have mostly involved refining selection, e.g. through data mining and more data. There is nothing wrong with that, but it's still a matter of doing the same thing, only better. There is a risk that enforcement focuses too much on the actor (the potential tax evader) since we always want to launch an investigation. But there may be possibilities of searching, instead, for circumstances which can be influenced (you don't



need to know who the scammers are in order to reply to Nigerian letters) and which can lead to reduced tax evasion.

It is important that the tax authority's task is seen as preventing and correcting errors and tax evasion, and not necessarily identifying every instance of tax evasion. This is not to suggest that the current working method should be abandoned altogether – on the contrary, it is probably quite appropriate on the whole – but there may be a need for complementary methods and experimentation with totally new ideas.

## **7.8 Don't look at enforcement in isolation**

The descriptions above show that enforcement can produce very good effects, particularly in combination with other measures. These other measures may be system-level measures but also e.g communication measures.

In other words it is not appropriate to regard enforcement activity in isolation, as a separate activity creating separate effects. If that were the case, the effects of enforcement would be relatively small. Bigger effects can be achieved if several measures are combined in a systematic and well-considered way.

This could have a bearing on how effect evaluations should be carried out, since it may be inappropriate, or meaningless, to carry out an effect evaluation of an individual measure in a limited context. Instead it is the cumulative effect on the system as a whole which is important. This may make it necessary to point out that each individual measure does not in itself produce such a lot of effect, but that together they do a lot of good.

As has been made clear above, different types of enforcement actions are also needed for different types of measures. Traditional enforcement by selection needs to remain, but it needs to be complemented with enforcement actions which are not based on tax returns, and with random checks. The latter in particular is often something which is needed (albeit on a small scale) in order to make system-level measures work, or in order to make it possible to obtain data on which to base new system-level measures.

The primary purpose of enforcement should be to strengthen social norms, but this can be done in different ways. Trade associations can be good collaboration partners in spreading information and influencing attitudes among businesses. But in order for a trade association to have something to work with, knowledge about e.g common errors can be very valuable. Thus enforcement, in this case with random selection, can lead to a system-level measure (carried out by a trade association) that will hopefully influence social norms and behaviour.

When the focus is on possible and expected effects, and measures are considered in a broad perspective, with innumerable combinations possible, it should be possible to develop more effective working methods. Enforcement is more than an investigative tool - enforcement is

about more than correcting errors – and enforcement should not be evaluated only on the basis of its direct effects. Enforcement gives a tax authority a big opportunity to achieve many different things.

## 7.9 Add new types of selection

As circumstances for enforcement change, and its area of application broadens, this of course affects selection. The traditional way of using large amounts of data and various types of algorithms to find suspected errors of course needs to continue being used, and also to continue developing. Random selections also need to continue being used, and also to be used more systematically.

Selections are also affected by whether an individual or a general prevention effect is being aimed for.

As mentioned above, selections are also needed that aren't aimed at finding errors or actors, but rather conditions or circumstances which may influence actors and lead to errors. This also includes selections for system-level measures. But in order to be able to do this in a good way, knowledge about what system deficiencies there are is key. Thus there may be a need for selections at the system level which are not aimed at identifying individual actors or errors – instead it is behaviour at the aggregate level which may be interesting.

Monitoring behaviour at the aggregate level can no doubt be done in many different ways, but one possibility would be to introduce an 'early warning system'. This could consist of an entirely automated selection that continuously monitors a large number of indicators or parameters (e g turnover and profit for various industries or other areas). When deviations beyond given limits occur, the system would signal this. The signals could be used to see behavioural changes that could possibly be dealt with through system-level measures or other measures. The point, however, is that a selection needs both a micro and a macro perspective (even if the latter overlaps with strategic intelligence and analysis work). It is reasonable that selection and analysis partially overlap, since both are about obtaining knowledge and finding things (e g occurrences, causes or actors).

Of course, in order to succeed in all this you need the right data and relevant information. Whether this involves a large or small amount of data is not so significant, as long as data processing is cost effective and meets stringent security and integrity requirements. What can be problematic is if you perceive large amounts of data, or 'big data', as a goal in itself, without a purpose or an idea of how all this data is to be used. It is easy to get lost in large quantities of data. Instead of the 'more is better' principle, the principle 'only what's right and relevant' should be used.

## 8 Conclusions

A number of conclusions may be drawn from the above description of the effects and functioning of enforcement. Used correctly, enforcement can be an effective way of improving compliance.

### **An important choice which has already been made – motives matter**

Each tax authority must decide whether it wants primarily to build a will to do the right thing, or if it would rather coerce or threaten people into the desired behaviour. Both methods work, in the sense that they have an effect on behaviour. In its adopted vision and strategy, the Swedish Tax Agency has already made its choice: to build a will to do the right thing. The reason people do the right thing matters, not just the fact that they do it.

There is much to suggest that this is the better choice. Besides being more appealing, the strategy is probably more cost effective since it is the more sustainable one in the long term. An Australian researcher, Valerie Braithwaite, points to these factors specifically in emphasising the significance of giving the taxpayer her or himself some say in the decision to comply. If individual will is made superfluous through coercion and rigid structures, the tax system will cease to be functional in the long term. Taxpayers must feel a moral obligation to comply and must perceive the tax system as fair.<sup>34</sup> Enforcement is a means to increase the will to do the right thing, not an end in itself.

### **Qualitative factors are crucial**

The qualitative factors of enforcement are crucial to achieving good effects. There may be reason to make further efforts to focus on these and to follow them up. This applies mainly to how enforcement is carried out, and particularly in terms of treatment and procedural justice.

### **Enforcement as a system-level measure**

One of the most important conclusions is probably that enforcement should be seen as, and treated as, a system-level measure. What this means is that enforcement effects should be aimed first of all at the system as a whole, i.e. the strengthening of norms and thus of the will to do the right thing among the taxpaying collective as a whole, over the long term. The general prevention effect should be paramount. This doesn't exclude effects on individuals or groups, but has implications for how enforcement is planned and carried out. Compared with the general prevention effect at the system level, which occurs because legitimate and credible enforcement exists, the effect on individuals and groups is relatively small.

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<sup>34</sup> Valerie Braithwaite, 2008, "Tax Evasion", Regulatory Institutions Network, Australian National University, Chapter for Michael Tonry, Handbook on Crime and Public Policy.

This may mean that it will become more difficult to prove causal links between measures and effects. However, effects still need to be measured and evaluated, but they have to be placed in a context. This, together with the fact that qualitative factors are crucial to good effects, implies that enforcement should not be planned, understood and followed up on the basis of linear mathematical models.

#### **Communication a decisive factor**

An important conclusion is that communication about enforcement can produce different effects from what enforcement itself does. The effects of communication are often greater, more important and more easily influenced. There is thus reason to attach more importance to and make a greater effort in communication. However, all communication must be truthful, and therefore the planning and prioritisation of enforcement must also be influenced by this.

#### **Complex causal links and the significance of context**

How enforcement works and how its effects occur is a complex matter. This is an important lesson, since it has implications for how we should procure knowledge and how we should interpret the results provided by different studies.

These complex causal links mean, among other things, that taxpayers' circumstances and environment have a considerable significance for behaviour. The ambition should thus be to influence these circumstances, including social norms, thereby influencing behaviour. Trying to change people's morals or values directly is likely to be less successful. Different personal motives are of course significant, but they vary from individual to individual, and it isn't meaningful to try to influence these since we cannot really know anything about an individual's motives and inducements. There is otherwise a risk that prejudices will enter into the assessments and that the cause of errors and tax evasion will be seen to be that 'there's something wrong with these people', even if that had not been the aim at the outset.

In other words it should never be a tax authority's view that there is something wrong with people; if there are problems, then there's something wrong with the circumstances instead. This is a more appealing as well as a more effective approach. For the same reason, it is both inappropriate and ineffective to try to risk assess individuals on the basis of how they are. As far as the Swedish Tax Agency is concerned, it is more appropriate and effective to look at what people do in different contexts.