

Can Salient Penalties and Enforcement on Tax Bills Increase Compliance Across Taxes?



An analytical model and a field experiment in Argentina proved that salient enforcement messages on one type of tax could increase compliance with another tax.



Salient messages of penalties and enforcement for the property tax had positive spillover effects on declaration of the gross sales tax, with taxpayers in the treatment group increasing their reported tax by 2 percent.



Taxpayers appear to assume that higher enforcement of one tax implies higher enforcement for others, thereby increasing their compliance across taxes.

CONTEXT

How does direct enforcement of one tax affect taxpayer behavior on other taxes? Presently, tax enforcement policies may not always consider the impact of a particular measure on behaviors involving other taxes. This phenomenon, when one factor affects other seemingly unrelated ones, is called spillover effects. This project explores the expected impact of making penalties and deterrence measures for one tax salient for other taxes. These findings can help policymakers better design tax enforcement strategies that consider a portfolio of taxes rather than a single tax.

PROJECT

The IDB and the municipality of Junin, Argentina, implemented a randomized field experiment with approximately 26,000 taxpayers of the property tax. One group received their tax bills modified with a salient penalty and enforcement message. To determine whether enforcement measures involving one tax could affect compliance with other taxes, the IDB collected information on reported sales and tax paid of approximately 700 taxpayers liable for both property and gross sales taxes. Among these taxpayers, the control group received regular property tax bills, and the treatment group received modified bills. An analytical model was also developed to understand the conditions under which spillovers could be positive or negative.

Key Concept



SALIENCE

Making key elements visible and prominent at the proper time and place is a vital tool that is as important as a message's main content.

RESULTS

1. The analytical model indicates that the spillover could be positive or negative depending on whether taxpayers assume that the higher deterrence in one tax would imply higher or lower deterrence in the other tax. The empirical results from the experiment indicate that salient penalties and deterrence messages on one tax increase compliance on other taxes.
2. Taxpayers who viewed the tax bills with salient penalties in the property tax declared on average 2 percent more gross sales taxes than those in the control group.
3. This group was also 7 to 9 percent more likely to report a tax payment larger than the minimum tax when compared to the control group.
4. When taxpayers receive information about enforcement of one tax, they not only paid more of that tax but also appeared to change their beliefs about enforcement of other taxes, as greater enforcement of one tax implied greater enforcement of other taxes as well. Given that most taxpayers are liable for more than one tax, tax authorities should design their control strategies taking into account possible spillover effect across taxes as well as the fact that penalties and detection may not be perfect substitutes.



Key Concept

SPILLOVER EFFECTS

Impacts of an occurrence in one area t on another seemingly unrelated area. Spillovers can be positive or negative depending on the type of impact they produce.

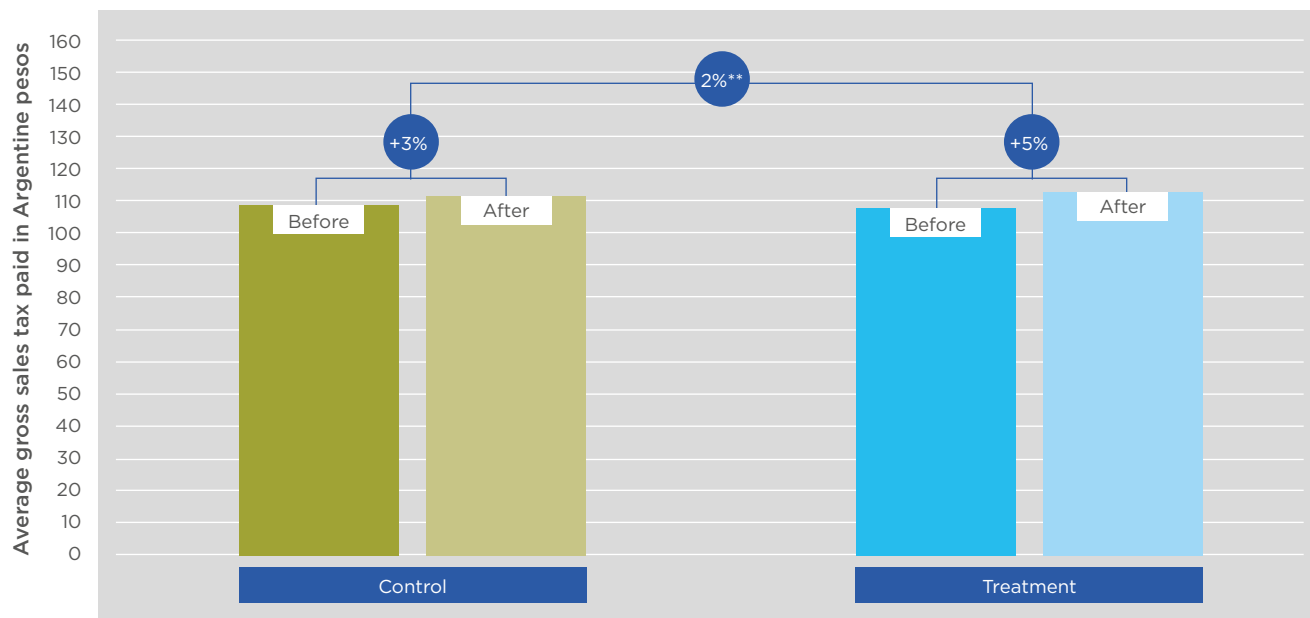
POLICY IMPLICATIONS

1. The size and type of spillover effect—whether positive, neutral, or negative—will depend on the deterrence message’s effectiveness in making the penalty salient for taxpayers.
2. How much people believe the government will enforce the penalty on more than one tax is also important in determining the magnitude and direction of a spillover effect.
3. In light of these findings, tax authorities should take a holistic view of their portfolio, considering enforcement strategies’ possible effects across taxes.
4. Including an example of what taxpayers would need to pay in the case of noncompliance can help increase the salience of the penalty by making its consequences easier to understand.
5. Enforcement messages and strategies need to be as realistic and achievable as possible to avoid reducing compliance with other taxes.

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Figure 1. Spillover Effects from Enforcement of Property Tax on Gross Sales Tax



*, **, and *** denote statistical significance at the 10, 5 and 1 percent level, respectively.



FULL STUDY

Lopez-Luzuriaga, A., and C. Scartascini. 2019. "Compliance Spillovers across Taxes: The Role of Penalties and Detection."

Also published in *Journal of Economic Behavior & Organization*.

DEPARTMENT OF RESEARCH AND CHIEF ECONOMIST

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