

Enhancing Voluntary Compliance by Reducing Compliance Costs: A Taxpayer Service Approach

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INTRODUCTION

The subject of tax compliance is the focus of a considerable body of theoretical and practical analyses. Many monographs, commentaries, and task force reports have dwelled not only on the tax structures of countries contemplating or implementing tax reform strategies, but also on the most efficient ways of improving taxpayer compliance¹. This trend can be explained by the fact that noncompliance² has become such a significant problem in both developed and developing countries and it must be addressed if the expected results of tax reform are to be realized³. Such evidence demonstrates the need for a correlation between tax policy formulation and implementation (Surrey, 1967; Jenkins, 1991).

This paper examines current measures for improving voluntary taxpayer compliance and suggests more efficient strategies for accomplishing this goal. The conventional approach adopted by most tax administrations is double-sided; some of them emphasize voluntary compliance through self-assessment, enforced by random, but stringent, auditing and penalties, while others simply stress the administrative assessment of all tax returns⁴.

We propose another model: self-assessment combined with a high level of taxpayer service. This approach proposes that voluntary compliance by taxpayers would be more effective and efficient (that is, would have lower administrative and compliance costs) if the tax administration put greater emphasis on assisting taxpayers in meeting their obligations⁵.

In this paper an overview is made of the determinants of voluntary tax compliance. Unlike previous treatments of this subject, the cost of taxpayer compliance is considered as an important determinant of the overall level of voluntary compliance in a country. A number of ways that tax authorities reduce compliance are discussed, and the most common uses of information technology in providing taxpayer service is described. Finally, the paper considers some of the ways that such activities might be monitored so that only cost-effective measures are implemented.

¹ Compliance is "the timely filing and reporting of required tax information, the correct self-assessment of...taxes owed, and the timely payment of those taxes without enforcement action" (American Bar Association, 1987). Examples of recent reports dealing with tax compliance as it relates to taxpayer service include: "Compliance 2000" (1992); Internal Revenue Department, Singapore, (1991); Vazquez Caro, Reid and Bird, (1992).

² Noncompliance is the failure to file returns, report income, calculate deductions properly as well as pay correctly and on time. For a detailed study of the typical categories of noncompliance, see Casanegra de Jantscher (1982).

³ It must be stated, however, that voluntary compliance levels vary widely. For instance, in a developed country like the United States approximately 81 percent of taxes owed from legitimate economic activities are voluntarily reported and paid (American Bar Association, 1987). This is clearly not the case with developing countries, where the tax gap (that is, the difference between the taxes actually remitted and the amount that would be remitted if all persons filed complete and accurate tax returns and paid all the taxes they owed) is much greater.

⁴ The more sophisticated tax systems place a much greater premium on self-assessment, whereas the less sophisticated give priority to administrative assessment.

⁵ A distinction needs to be drawn between efficiency and effectiveness in the compliance context. An efficient administration is one that minimizes the administrative cost per dollar of tax revenue, while an effective administration is one that minimizes the degree of noncompliance through the implementation of appropriate controls (Silvani, 1991).

This is done by providing outreach services, technical advice on tax payment obligations, and allowing taxpayers to file and pay in ways that minimize compliance costs. Policymakers should seek to improve the self-assessment model inherent in voluntary compliance by drawing on the vast resources and opportunities offered by the nexus of computer-generated information, the tax laws and regulations applicable to particular types of taxpayers, modern communication techniques that can focus on targeted sectors or groups, and the availability of third-party income and transactions information. The information generated and disseminated by such means could be crucial in ensuring that taxpayers discharge their tax obligations more effectively and efficiently.

Another model for improving voluntary compliance is proposed: self-assessment combined with a high level of taxpayer service

The paper is divided into two parts. Part I provides an overview of the subject of taxpayer compliance, reviewing some prevailing theories of compliance and discussing the literature on compliance costs. Part II of the paper presents the case for a taxpayer service approach which emphasizes the provision of a wide array of options and facilities to taxpayers, enabling them to fulfill their tax obligations more easily and with optimum results. In addition, it contains a discussion of the rationale for taxpayer service and assesses policies within the new framework that the tax administration could pursue in order to improve voluntary compliance.

The paper also discusses attendant issues, such as enforcement measures, personnel training and performance, as well as research on taxpayer compliance behavior. It concludes by recommending that efforts aimed at promoting voluntary compliance be undertaken as part of a broader tax reform strategy.

TAXPAYER COMPLIANCE: A CONCEPTUAL FRAMEWORK

The concept of voluntary compliance

In both income and value-added tax systems, the tax authorities have tended to administer the tax regime in a way that encourages and expects taxpayers to self-

assess their tax liability and then remit the relevant amount of tax to the government. This is a conceptually sound approach since the taxpayer has better information on his sources of income and it is relatively expensive for the government to assess every taxpayer's return. Nevertheless, self-assessment must be accompanied by mechanisms that ensure high levels of compliance. These measures, such as taxpayer service and enforcement, must address the behavioral factors that determine the level of tax compliance in a population.

However, the concept of voluntary compliance cannot be adequately examined without a sufficient prior understanding of the general framework of taxpayer compliance. There has been a steady growth over the years in the volume of literature on voluntary compliance and tax evasion. Melia (1987) has delineated four doctrinal strands: economic models, uncertainty models, norms of compliance and the inertia model.

Typology of compliance models

Economic models

The basic point advanced by theorists⁶ of this school is that the rational taxpayers' main goal is to maximize their financial position. Consequently, they will continuously attempt to evade taxes when the benefits from tax delinquency outweigh the risk of detection and punishment. Gary Becker emphasized that, in general, certain persons engage in illegal conduct not because their basic motivations differ from those of "honest" people, but because their costs and benefits differ⁷. The economic analysis thus concludes that since compliance decisions are based on an assessment of costs and benefits, high probabilities of detection for noncompliance and large penalties for discovered violators would encourage greater compliance, hence maximizing tax revenue streams.

⁶ Some economists who have addressed the issue in detail are Allingham and Sandmo, 1972; Srinivasan, 1973; Mason and Calvin, 1978, 1984; Ekstrand, 1980; Grasmick and Scott, 1982; Clotfeiter, 1983; and Witte and Woodbury, 1985.

⁷ Becker, G.S., "Crime and Punishment: An Economic Approach." *Journal of Political Economy*, 1968.

Uncertainty models

These models are an extension of the economic model rationale. While retaining the assumption that rational taxpayers seek to maximize their financial interests, adherents to this model point out that in the real world information about penalty provisions and the risk of audit is imperfect. As a result, present or potential taxpayers have to rely more on the perceived, rather than the actual, risk of detection and penalty (Friedland, 1982; Kahneman, Slovic and Tversky, 1982). Consequently, most taxpayers who have been audited once are more likely than those who have not been audited to comply with their tax obligations, even though the risk of their being audited again is no higher than before.

Norms of compliance

These are standards of taxpayer behavior that are influenced by the tax culture. There is reason to believe that societal reasons may account for the way taxpayers behave. While tax evasion may be considered wrong and immoral in some societies, it may be regarded as socially tolerable in others (Schwartz and Orleans, 1967; Ekstrand, 1980; Warneryd and Walerud, 1982). In countries with a tradition of high compliance with the tax law, few taxpayers would attempt tax evasion strategies. However, empirical evidence seems to suggest that taxpayer compliance with the law is influenced by their perceptions about whether or not other taxpayers are complying (Van den Doel, 1978; Laver, 1981; Lewis, 1982), especially when they feel that the taxes they pay are intended for worthy purposes (Oldman, 1965; Dean, Keenan and Kenney, 1980) ⁸.

The inertia model

Subscribers to this theory assert that after an individual routinely engages in a given practice, he has little incentive to change. By the same token, taxpayers who have a history of compliance with the law do not tend to evade their responsibilities. This is not due to high risks of detection or some overarching moral imperative, but rather because they have nurtured a habit of

compliance (Spicer, 1986). The psychological underpinnings of the inertia theory are rooted in Festinger's theory of cognitive dissonance (Festinger, 1957), which states that "when an individual holds inconsistent beliefs or acts in a way inconsistent with his beliefs, unpleasant feelings arise. In turn, these feelings push the individual to change either his beliefs or his behavior, so that one is consistent with the other" (Melia, 1987).

The implication is that once a taxpayer begins to engage in non-compliant behavior, his commitment to obeying the law declines and his sense of the impropriety of the act fades. The result is that inertia sets in and it becomes increasingly difficult for him to change his habits (Spicer, 1986).

The costs of compliance, administrative costs and burdens borne by third parties reflect the complexity of the tax system

These theories have enormous practical implications for both policymakers and tax administrators. Those aspects of the theories which focus on the psychological and social determinants of compliance are very important because they challenge normative assumptions about taxpayer behavior, and are, therefore, central to the design of new policy initiatives that address compliance problems directly. At various points of the discussion in Part II, elements of these theories are drawn on in order to address the problems that they highlight and to suggest some practical solutions relating to the improvement of voluntary compliance by taxpayers.

The costs of taxpayer compliance

Compliance costs in brief

Administering a tax system involves various kinds of costs (Sandford, Godwin and Hardwick, 1989), which will not be analyzed in detail in this paper. Although a portion of tax collection costs is incurred by the tax administration, it is important to note that taxpayers bear a substantial share by virtue of the time and money they spend trying to comprehend the tax laws applicable to them and filing the relevant returns. Therefore, the total cost of any tax system includes not only the resources spent on revenue collection, but the costs incurred by taxpayers and third parties in complying with various structures and levels of tax.

⁸ However, see Spicer and Lundstedt, 1976; Mason and Calvin, 1978; Song and Yarborough, 1978; Yankelovich, Skelly and White, Inc., 1984, for their discussion of the mixed evidence on the link between taxpayer perceptions of overall compliance and their own compliance.

Typically, in the case of the income tax, it is necessary to keep complex and detailed records of transactions and to grasp the implications of tax rules that treat alternative income sources and transactions differently. Individuals who itemize must spend additional time to keep and organize records of deductions. Sometimes the forms are difficult to obtain and have conflicting instructions. Such factors make compliance difficult and costly, often necessitating the hiring of professional tax advisors or planners. Additionally, most taxpayers spend a significant amount of time reading the instructions attached to their returns (if such directions exist at all), compiling and maintaining records of income sources and taxable transactions, and deciding which forms are relevant. Some taxpayers use manuals and computer programs to study the tax literature in order to try and identify tax-saving provisions from which they might benefit.

Compliance costs thus refer to "the value of the time spent on tasks related to filing....tax returns, as well as to any expenditure on goods and services for that same purpose" (Blumenthal and Slemrod, 1992). The costs of compliance, administrative costs, and burdens borne by third parties often reflect the complexity of the tax system. Therefore, simplifying the tax structure or providing other forms of taxpayer service can significantly reduce compliance costs.

Survey of the literature

The modern literature on compliance costs is considerable. Wicks (1965, 1966) conducted the first studies of compliance costs based on survey information. He concluded that the average Montana taxpayer spent \$88 worth of time, money, and effort to comply with the federal income tax law. He determined that this amount was approximately 11.5 percent of the revenue collected, with the highest compliance costs being borne by the self-employed and persons engaged in sales, professional, and managerial occupations.

The U.S. Commission on Federal Paperwork estimated in 1977 that the component of compliance costs of the individual income tax system that involved preparing tax returns and keeping records was \$4.6 billion (that is, 3 percent of income tax revenue). Slemrod and Sorum surveyed the compliance behavior of 2,000 Minnesota households in 1984 and found that the average taxpayer spent 21.7 hours on tax-related matters, which amounted to a total of about 2 billion hours. They calculated that the combined time and

money costs amounted to 5-7 percent of income tax revenue. Arthur D. Little obtained similar results (1.59 billion hours) in 1988.

In Canada, Vaillancourt (1986) conducted face-to-face surveys of 2,040 taxpayers in all ten provinces concerning the income tax compliance costs they incurred in 1985. He concluded that, on average, 5.55 hours, or C\$84.80, were spent on compliance activities. Additional out-of-pocket costs estimated at C\$32.40 brought the average total compliance costs to C\$117.20. Mean calculations also showed that compliance costs increased with income and education level, as well as with tax law complexity. Therefore, Vaillancourt concluded that tax status characteristics, rather than personal characteristics, could explain changes in the amount of time spent on tax-related issues. He also analyzed the compliance costs of sales taxes in Canada in 1992 and found that compliance costs as a percentage of tax revenues ranged from 0.674 percent for relatively large firms to 2.77-32.15 percent for relatively small firms.

In Britain, where a greater compliance-enforcement responsibility is borne by the state, Sandford surveyed individual income taxpayers in 1973 and concluded that the highest compliance costs were incurred by the same groups observed in the Wicks study. Sandford, Godwin, and Hardwick (1989) also carried out a survey of the compliance costs borne by taxpayers in the United Kingdom during the period 1983-84. They estimated that, with regards to the individual income tax, compliance costs amounted to approximately 3.6 percent of revenues raised. However, compliance costs varied significantly with the type of tax forms used by taxpayers.

More recently, Blumenthal and Slemrod (1992) studied compliance costs following the 1986 Tax Reform Act. They concluded that not only has there been an increase in the compliance costs of individual taxation, but that there was no evidence that the Act reduced the upward drift in cost trends. These studies demonstrate the extent to which tax administrations need to curb compliance costs.

THE TAXPAYER SERVICE APPROACH TO VOLUNTARY COMPLIANCE

Although the self-assessment function facilitates the voluntary compliance process, the amount of compliance costs borne by taxpayers is likely to be an important factor in determining the overall success of

this approach. At the core of the taxpayer service model is the proposition that a higher level of service helps to reduce both the financial and psychological level of compliance costs, which in turn leads to an increased level of voluntary compliance. Our recommendations attempt not only to integrate and apply the theories reviewed in Part I, but to evaluate the possible implications of taxpayer service for better tax enforcement.

The taxpayer service concept

Spending resources to conduct an administrative assessment of tax liability or to mitigate taxpayer noncompliance exclusively through auditing and penalty assessment is ultimately very costly. We propose that taxpayer services, such as electronic filing, tax simplification, continuous withholding, and taxpayer education, would foster voluntary compliance by reducing the taxpayer's costs (Delorme, 1980; LeBaube and Vehorn, 1991; Silvani, 1991). Taxpayer education is especially crucial because the size of the information gap in the tax system is inversely proportional to the level of voluntary compliance⁹. Taxpayer service is thus a set of measures undertaken by the tax administration that are designed to assist taxpayers in complying with the tax law. But why taxpayer service?

Total tax revenue is affected by both administrative and compliance costs. Therefore, delivering more effective service to taxpayers would cause the tax administration to incur higher administrative expenses unless it was able to achieve a larger reduction in enforcement costs. We contend, however, that the gains from lower compliance costs and improved taxpayer performance are likely to outweigh the increased administrative costs. Using the taxpayer service to reduce the costs incurred by taxpayers in their efforts to understand the law or to complete their self assessments and make payment may be a cost-effective way to increase the overall level of compliance.

⁹ By information gap, we mean 1) the gap between the taxpayer's actual liability status and the extent of the tax administration's knowledge of that status, and 2) the gap between the taxpayer's knowledge of his own tax liability status and his actual status. Taxpayer service helps to bridge this gap because it effectively pools information which would otherwise be unavailable to either party.

The central role of automation and information systems

Technology is a crucial component of the taxpayer service model (Venner, 1992; Marshall, 1992; and Mason, 1992). Given the dramatic fall in the price of information technology relative to manpower, the provision of outreach services to present or potential taxpayers cannot be cost effective without the use of technology-based products. In fact, automation that integrates a wide array of information or payment systems is inextricably linked to optimal taxpayer service.

Compliance costs increase with income and education level, as well with tax law complexity

Besides helping to track and identify potential taxpayers who have not been reached previously (whether because they are non-filers or stop-filers), modern computerization and electronic filing facilities (paperless data collection via tapes, diskettes, or EDI) would help significantly in improving compliance behavior. For instance, modern technology permits the use of a unique taxpayer identification numbering system which allows for extensive cross-referencing, including VAT and customs duties. Using computerized profiles of delinquent taxpayers also enables enforcement resources to be targeted towards likely tax evaders, thereby improving compliance levels in the most cost-effective way. The existence of magnetic media guarantees the high quality and inexpensive storage of data, reduces the risk of documentary fraud, and facilitates the rapid retrieval of taxpayer data.

In addition, by serving as a link between the taxpayer and the tax administration, such technology can accommodate any tax compliance enforcement operation, whether it requires a centralized or decentralized apparatus. Ultimately, what is crucial is not so much the level of centralization or decentralization of enforcement efforts, but rather that the design of strategies to generate and pool taxpayer information minimizes costs.

Some components of taxpayer service systems

A wide variety of strategies are available to facilitate taxpayer service. However, one key organizing principle that guides any policy to improve taxpayer service is

the necessity of delivering, at the lowest possible cost, information that can be used effectively by taxpayers and the tax administration.

In this paper we organize the various potential components of a service oriented administrative strategy into three broad areas, namely: tax simplification, taxpayer assistance, and the facilitation of tax collections and enforcement. Within each of these areas we can identify a number of potential service components made possible by either modern management techniques or current advances in information technology. In the future new applications will be developed. The ones briefly discussed here are only a sample of what is being implemented now by tax authorities around the world.

Tax simplification

Most commentators, policymakers, and tax administrators agree that voluntary compliance would be greatly facilitated by the existence of a simplified tax structure. Indeed, without institutional simplification that enables taxpayers to fulfill their responsibilities more effectively, even the most elaborate service offered to taxpayers by the tax administration would be lost in a sea of confusion, waste, and widespread disrespect of the law (Bahl, 1989; Jenkins, 1992). A simpler tax structure will make it easier for taxpayers to assess their tax liability and thus comply more fully with the tax laws. Current worldwide trends bear ample testimony to this fact. Tax reform efforts in the United States, Canada, Europe, Australia, and Latin America, for instance, focus on the elimination of numerous features in the economy that further distort and complicate the tax system.

In addition, a simpler tax system saves tax administrators the time and strain of trying to figure out what avoidance actions taxpayers might take in a bid to lower their tax liability. Many of the costs borne by taxpayers are primarily attributable to the complexity of the tax law. The need to understand tax provisions, determine which ones apply to what income or transactions category, select the appropriate tax forms, and file the tax return is directly related to the complexity of the tax law. For this reason, simplifying the tax law would greatly reduce compliance costs because taxpayers would be able to obtain the requisite tax information with less difficulty. Although assessments of the extent of

simplification ultimately accomplished by the 1986 U.S. Tax Reform Act may vary, it is clear that the Act achieved some progress because tax rates were reduced and tax shelter incentives curbed. Similarly, tax reform efforts carried out by many other countries have mainly involved the reduction of rates and the broadening of tax bases.

Tax law simplification can take at least two forms; the substantive simplification of tax regulations or the simplified application of tax rules.

i) Substantive simplification of tax rules

This species of simplification is the conventional one. It involves a streamlining of tax rules through the reduction of exceptions, exemptions, or caveats. For example, the New Zealand VAT has one of the broadest bases, hardly exempting any transactions. The consequence is that the interpretation of the law is easier and its observance is straightforward. The case of Canada is a good illustration of the perverse consequences that can be produced by elaborate and complex definitions. For example, the GST zero-rates food, but the definition of what constitutes food has led to a situation where an item could be considered to be either food or a taxable snack depending on how many slices the food package contains. Overall, however, the main attractiveness of using a VAT in a complex and advanced economy is that its provisions can be simplified, which is not usually feasible with any form of income tax.

ii) Simplified application of tax rules

Even if tax provisions are simplified, compliance costs may not be reduced significantly if selected information is not communicated to the precise groups concerned. Tax rules need to be communicated directly to the appropriate sectors irrespective of their complexity. The function of the tax administration is to ensure that tax rules reach their targets in as effective a fashion as possible. For instance, the tax authorities could publish individual manuals on sales taxes, income taxes, corporations, or partnerships, as they apply to particular sectors. Such targeted information reduces compliance costs because it relieves the taxpayers from having to expend time and money learning tax rules that may not be applicable to them.

One additional problem is that policymakers tend to underestimate the degree of noncompliance with the

tax law that is caused because tax forms are often too complicated to understand. Tax administrators often design forms and information bulletins which render the tax filing process so complicated as to require the assistance of tax preparers, accountants and lawyers. Such assistance is costly. Taxpayers would thus incur lower compliance costs if the simplification of the tax regime also involved a simplification of the tax forms. One solution is to broaden the scope for self-assessment as much as possible while simplifying the basic directions that taxpayers have to follow. In many developing countries, the adoption of a VAT ensures simplification of the compliance process because the tax tends to be broad-based and has fewer rates than the taxes it replaces. Its introduction thus enables transactors to incur lower costs in reporting their activities.

Taxpayer assistance

Taxpayer assistance must deal with more than the provision of information to prepare the tax return. It also should include issues of filing, and the resolution of questions and adjustments that may arise after the tax returns have been submitted to the tax administration. The items outlined below only are suggestions of what some tax administrations are now undertaking in their taxpayer assistance programs.

There must be a close connection between voluntary compliance, taxpayer attitudes, taxpayer service and the maximization of revenue generation

i) Assistance to prepare tax returns

Public outreach programs should be initiated that are aimed at informing taxpayers on how to comply with the tax system or explaining recent changes in tax legislation. This new approach, which consists of extensive use of media markets such as radio, television, and print outlets, as well as community-wide talks and seminars, should become a permanent feature in every tax system. Recent programs in the United States¹⁰ and in Australia¹¹ which set forth strategies for taxpayer service delivery in the future, are examples of efforts to upgrade taxpayer assistance in order to reduce compliance costs.

Clearly, taxpayer assistance would help to curb litigation (which is at once a compliance and

administrative cost) because the interaction between the tax administration and taxpayers would enable the latter to clear up *ex ante* any uncertainties they may have about their tax liabilities. If the tax law is not clear about the application of particular provisions, self-assessing taxpayers will find it helpful to be able to rely on taxation department opinions and advance private rulings to determine their tax liability.

Taxpayers tend to ask similar questions, especially during tax filing time. An effective way of addressing this issue is to compile and computerize the most common questions and answers and retrieve them when necessary. The rapid retrieval and dissemination of on-line information from a public enquiries information bank for use by taxpayers can curb both administrative and compliance costs.

To accompany any substantial simplification of the tax law, the government needs to have a consultative process involving the production of tax forms tailored to meet the needs of older people or those who lack sophistication in tax-related matters. Furthermore, there is a need to rewrite tax guides in plain language, and to simplify tax tables for employers and employees alike.

In a bid to improve taxpayer assistance, annual surveys may need to be conducted in order to monitor what perceptions taxpayers and tax agents might have about taxpayer service delivery and other compliance issues. Additional research could also be carried out on compliance costs, market segmentation and client profiles, the characteristics of client behavior, compliance levels, and business practices. Experiences in the United States and Canada are cases in point.

ii) Tax information phone service

This is a computerized voice-response phone service that enables clients to obtain information about specific tax topics or issues. Taxpayers can use this service from any push-button phone that has tone signalling and "touch tone" service. Information about tax law changes, client services, tax return processing, and tax refund schedules can be obtained via this phone service. If the service is available 24 hours a day, or at least during peak tax filing times, it has the potential of curtailing both administrative and compliance costs substantially.

¹⁰ Cf. *Department of the Treasury, IRS (1992)*.

¹¹ Cf. *Australian Tax Office (1992)*.

iii) Electronic filing

Electronic filing contributes towards the lowering of compliance costs because it enables taxpayers to file their returns directly to the tax authorities via computerized operations. In addition, it enables the fast processing of returns, reduces errors, curbs paper use, saves space and decreases other handling or processing costs. In the United States, Canada, and New Zealand, for example, electronic filing now facilitates to a considerable degree the exchange between the tax administration and tax preparers, accountants, and lawyers. The practice of electronic filing in Canada and the United States has already been very instrumental in reducing compliance costs. It is expected that individual electronic filing will soon be available to many more taxpayers who could gain access to the system by dialing up a dedicated host computer in the tax administration.

Basically, taxpayers and the tax administration need only to match their software systems in order to facilitate compatibility, thus permitting information transfer and exchange. The data transfer system is comparable to the payment system currently linking banks and other entities.

iv) Electronic Data Interchange (EDI)

EDI provides direct communication links between the government, financial institutions and firms. Such systems facilitate both the exchange of information and the transfer of funds. It can curb compliance costs due to the reduction in time and paper work to complete transactions. In Singapore, a nation-wide EDI network was implemented in 1989 to develop the TRADENET system which facilitates the completion of business for international trade transactions (Yeow, 1992). This EDI system has linked the port, transportation companies, customs brokers, customs administration, importers, and banks together to enable the issuance of permits, the clearance of goods, payments of taxes and charges on a 24 hour basis with minimal use of manpower. Of course, such a system requires the initial infrastructure of a reliable telephone communications system.

v) On-line correspondence system

Any tax administration must cope with a large volume of correspondence from both taxpayers and professional tax advisors. Many of these inquiries will deal with

complex questions on which the tax authorities should give timely and consistent replies. In a large organization it is difficult to maintain such consistency across regions and over time.

The availability of an on-line correspondence system allows the tax officials who are addressing a particular tax question to have access to the replies of other officers. The advantage of such a system is the rapid searching capability of text database software. Since letters can be displayed on-screen, the tax administration staff and their managers can view the mail created in the system and resolve whatever problems exist before they are sent to the taxpayers. Such a system not only improves correspondence between clients and the tax administration, but also eases intra-service communication.

vi) Public facsimile service

The need for the operation of a public facsimile system by the tax administration cannot be easily challenged because it would allow for quick correspondence between the tax administration and taxpayers. However, the implications of setting up such a service need to be thought through. There is the possibility that the service might trigger the generation of the kind of paper flow volume that computerized information systems are designed to reduce.

Facilitation of tax payments and enforcement

i) Tax payment systems

Instead of relying on checks received through the mail, the tax administration could institute a process whereby taxpayers can remit tax payments ahead of tax filing time by depositing the amount in a post office, obtaining a receipt for the payment, and ensuring that the amount is credited to their account within the shortest time possible¹². This service has the advantage of acting as a withholding technique for taxpayers who want to avoid the later burden of having to come up with the money needed to fulfill their tax liability. Further, it enables taxpayers to avoid the risk of incurring penalties for late payment.

¹² The new "Billpay" service in Australia is an example of this procedure (Australian Tax Office, 1992).

Payment at the bank is an even more direct way of settling tax liabilities in advance. As with payment at the post office, the taxpayer need only have a taxpayer identification number to facilitate payment. In this context, taxpayers are able to electronically remit PAYE payments into their tax accounts in much the same way that salaries are paid directly into bank accounts. The speed and certainty of this method not only improves cashflow management for both taxpayers and the tax administration, but also reduces compliance costs¹³. The security afforded by the system, as well as its reliability and convenience make it a very suitable innovation for countries contemplating or undergoing reform. Electronic payments to the bank can be made under income tax, sales tax, or property tax regimes.

In Singapore, a service called the Integrated Receipting System (Singapore, 1992) now provides one-stop service by allowing payment of income and property taxes at the same tax service location. This service helps to facilitate not only tax payment, but also the cross-checking of tax liabilities. It needs to be periodically updated in order to be useful to taxpayers at all times.


ii) Withholding

The use of a withholding tax¹⁴ is an effective way of implementing voluntary compliance because it is at once a preventive policy and a service. It is preventive in that it enables taxpayers to fulfill their tax obligations fractionally so as not to be burdened by a substantial tax bill at the end of the tax year. In this connection, both the state and the taxpayers concerned spare themselves the trouble of having to endlessly negotiate late tax payments. The tax administration can curb noncompliance preemptively by broadening the scope of withholding taxes at the source.

One effective species of this technique is the pay-as-you-earn (PAYE) or interest withholding scheme. Withholding amounts in excess of the taxpayers' liability and then remitting a refund to them tends also to improve tax compliance for sources of income

which are not subject to withholding, as the declaration of this additional income for most taxpayers will result in a lower refund not an additional payment. It also does not require them to undertake an additional filing solely because they have additional sources of income on which taxes have not been withheld. This scheme can be quite effective, as shown by some developing countries (Thailand, for instance), where withholding generates about 50 percent of personal income tax revenue (World Bank, 1991).

Withholding can also be useful in the VAT context. This is because, the VAT system can still be vulnerable to taxpayer noncompliance despite its attractive self-policing structure. Efforts have been made in Turkey and Bolivia to improve compliance through a system by which wage earners receive rebates commensurate with their expenditure on certain classes of goods and services. However, the enforcement costs of such a design can be substantial, and must be assessed in relation to other strategies or simply used as a temporary measure¹⁵.

 Ideally, taxpayer service should be proactive, rather than reactive

Withholding can also be a service. By facilitating the incremental pre-payment of taxes based on the estimated value of annual income streams, the tax administration serves taxpayers' needs to a reasonable extent. It enables them to keep track of their tax liabilities or their possible tax credits. The information yielded by withholding thus makes it easier for some taxpayers to allocate their consumption or investment resources ahead of time. In Chile, millers withhold VAT on behalf of both farmers and bakers because of the central role they play in the bread-making process. In this way, they provide a service to both groups and to the government by serving as repositories of tax collection.

Lastly, since the credit card industry is already equipped with the payment systems and enforcement mechanisms that allow it to operate efficiently, the tax administration might consider using similar systems to withhold indirect taxes on a continuous basis. Alternatively, the major credit card entities could align their systems and services with those of the tax administration in order to make the withholding process more efficient and effective.

¹³ The Direct Deposit System in Canada, the EFI-In program in Australia, and the Direct Crediting System in New Zealand are all varieties of this payment system.

¹⁴ Basically, the withholding tax "requires a payor to withhold a percentage specified by law from his payment and to remit this withheld amount to the government" (Yudkin, 1971). For a detailed analysis of various issues relating to withholding, see also Soos (1990).

¹⁵ In 1986, the total cost of the expenditure rebate system for Turkey was 39 percent of net VAT revenue--approximately 1.5 percent of GNP (World Bank, 1991).

iii) Information for enforcement

A management information system is also instrumental in facilitating the enforcement of tax rules. Automation, which constitutes the bedrock of taxpayer service, facilitates the pooling of information from assorted sources which can be useful in the process of matching third-party information with tax returns. It clearly helps to reduce the administrative costs associated with enforcing compliance. The fact that many taxpayers are aware of the availability of information regarding their transactions or income sources deters them from attempting to avoid or evade their tax obligations. Stop-filers can also be quickly discovered.

In cases where third-party information on transactions is easily available to the government, it may become cost-effective to have the administration allocate these revenues to the preprinted tax forms of taxpayers, hence reducing their compliance costs.

Information pooled and disseminated by automation processes can also be useful for audit purposes. In Canada, for example, computer tracking systems are used to spot taxpayers who have not filed a current-year return, and the Computer Assisted Audit Selection System (CAAS) allows for the computerized screening of thousands of tax returns and selects those that appear to require review by experienced tax examiners¹⁶.

iv) Expert systems

Expert systems are being developed to assist in the interpretation of tax laws and in the auditing of taxpayer returns. They involve the development of computer-based systems that blend the knowledge and reasoning of experts in order to assist tax officials in the handling of questions, enquiries or audits. These systems curb compliance costs because they reduce the interference time caused by audits and help to provide consistent, precise, and timely answers to enquiries about complex areas of taxation. In Canada, for instance, a major effort has been made to build such a system, the Residency Determination Advisory System (RDAS), that is used in the

determination of the residential status of taxpayers, (Venner, 1992). In Canada the tax authorities also used expert systems with portable microcomputers to assist field auditors for the Goods and Service Tax (VAT) (Marshall 1992). This is an area that we can expect to see being developed further in the future, however, such systems are costly to build and tend to be economic only in those areas where they will receive heavy usage.

Some implications of the taxpayer service approach

There is no doubt that taxpayer service has numerous implications for any tax system. First of all, it is conceivable that in many countries, policymakers who are constrained by limited financial resources might not be able to set up the variety of facilities needed to induce taxpayer education, even though the tax administration is aware of the strategic necessity. There may well be other priorities, such as tax structure reform, that policymakers may consider to be more pressing. The solution might be to carefully sequence the reform process so that the front-loading is manageable and no phase lags substantially behind the other.

Contrary to expectations, the taxpayer service approach cannot be easily replicated in dissimilar contexts. For instance, the asymmetrical strategic and long-term needs of developing and developed countries make it likely that recommendations which might be distinctly useful to one group of countries will not be useful to another. This implies that factors other than financial implications, such as political will, economic structure, tax culture, compliance history, and taxpayer perceptions of the degree of fairness in a given system, will affect the design of customer service (Peterson, 1992).

Finally, the ability of the taxpayer service to generate and pool information on the status of taxpayers can lead to the misuse of otherwise confidential records by unscrupulous persons. Experiences with the dissemination of incorrect credit records and inadequately regulated sales of credit card information to unknown third parties are phenomena which are currently challenging the boundaries of individual privacy. It is, therefore, necessary that the implementation of taxpayer service be accompanied by strict confidentiality rules to be observed by users of the generated or pooled data.

¹⁶ CAAS uses business sector comparisons with adjustments for geographical and economic properties that are likely to affect the standards and ratios ordinarily used for business sectors or groups.

Attendant measures

a) Additional research on compliance behavior

Taxpayer service can be improved if annual surveys are conducted to monitor taxpayer and tax agent perceptions about taxpayer service and other compliance issues. Research needs to be carried out in order to measure compliance costs, market segmentation and client profiles, the characteristics of client behavior, compliance levels and business practices, as well as to study the relevance of strategies to the needs of taxpayers (Australian Tax Office, 1992).

b) Optimal personnel training and performance

The successful implementation of taxpayer service requires a skilled labor force with a broadened perspective of the tax system. In developing countries, tax reform projects are often so sweeping that sophisticated information processing systems are introduced long before the trained staff needed to run them are available locally. For this reason, expatriate staff are often employed for long periods before local professionals are available. To address this issue, tax administrations need to make technical training and managerial capacity-building priorities as they map compliance improvement reform (Glenday, 1992). In Ghana, Indonesia, Jamaica, Malawi, and Thailand, the reform of the tax structure has been accompanied by the modernization of detection procedures and an upgrading of staff training and managerial capacity. It must be noted, however, that the advent of micro computers, and fourth generation software languages, has made it dramatically easier for persons with minimal sophistication to use information technology applications competently after receiving basic training.

CONCLUSIONS

Taxpayer service helps to curb compliance costs by providing programs that enable taxpayers to fulfill their obligations more easily. It facilitates information discovery, retrieval, and dissemination through automated systems that pool information and allow for the efficient identification and retrieval of specific data. Ideally, taxpayer service should be proactive, rather than reactive.

To have its expected impact taxpayer assistance should be geared towards achieving specific objectives that are linked to broader tax reform goals.

This paper has discussed the need for tax administrations to shift to a voluntary compliance regime that is backed by both taxpayer service and enforcement strategies. The assessments done to date of the benefits and costs of such a shift in emphasis suggests that the long-term advantages of a taxpayer service approach far outweigh its short-term costs.

To be sure, advocating the introduction of taxpayer service does not imply that enforcement measures aimed at improving voluntary compliance should be abandoned. Rather, it recognizes that a broader range of factors, including compliance costs, are important determinants of the overall level of voluntary compliance. Changing the tax structure may be used to immediately eliminate some forms of noncompliance. Taxpayer assistance can be economically beneficial by lowering compliance costs by more than the increase in administrative expenses. Furthermore, more efficient collection techniques can improve the overall operation of the tax system while reducing its overall administrative and compliance burden.

In short, by reviewing some aspects of the taxpayer service approach, this paper has attempted to establish that in the design of a cost effective tax system there should be a close connection between voluntary compliance, taxpayer service, and the implementation of information technology products.

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