

Horizontal Monitoring for Increasing Tax Compliance

Aims of the activity/of the project	The aim of this project was to supervise the pilot phase of Horizontal Monitoring – a new type of cooperation between tax authorities and companies – in Austria.
Persons responsible for the project	Univ.-Prof. Dr. Erich Kirchler (University of Vienna, Faculty of Psychology, Department of Applied Psychology: Work, Education and Economy)
Cooperation partners	Federal Ministry of Finance

Project Description

The idea behind Horizontal Monitoring (HM) is for tax authorities to meet taxpayers on an equal footing, and not to view them solely as “subjects” who have to follow the law anymore. At this, fairness in dealing with each other is the basis, and control and punishment are no longer used as “educational measures”. Instead, a code of conduct for the interaction is being developed. This includes firms (usually larger companies) making their business practices more transparent for the Federal Ministry of Finance and tax offices, respectively – this means that company data are being transmitted to the tax authorities voluntarily. This code of conduct also involves that tax authorities provide explicit information on tax consequences of certain investments to firms. This information is legally binding so that firms have legal security. The new aspects, compared to traditional vertical monitoring, are transparency on part of the firm, legal validity of information on part of the tax authorities and the principal of fair play in dealing with each other. This idea was proclaimed by the OECD under the term “co-operative relationships”. HM has been at least partly implemented in the Netherlands since 2005, and has been in trial phase in Austria from 2012 to 2016.

The conception of HM strongly corresponds with the “Slippery Slope Framework”, developed and published by Erich Kirchler and his team. This research was brought into ministries by the OECD and finance (e.g. Fiscalis), and was perceived very positively. The “Slippery Slope Framework” integrates results from research on economic and psychological determinants of tax compliance and identifies two primary dimensions: (1) the power of (finance) authorities and (2) the taxpayers’ trust in these authorities. These dimensions and their interaction determine whether citizens comply through enforcement or voluntarily. Thus, the framework presented itself as an ideal theoretical basis for HM.

Erich Kirchler and his team were invited to multiple major events for employees of finance ministries and offices and other stakeholder as well as to events for firms interested in HM in order to present the concept of the “Slippery Slope Framework” and HM. In addition, the team is involved in the evaluation of the HM pilot phase in Austria.

The team was also involved in the implementation of HM in the Netherlands by means of invitations for presentations and events for the information of various stakeholders. The Netherlands have a separate team of psychologists who supervise the HM implementation process – both teams exchange experiences on a regular basis.

Results/Impact

On the one hand, the pilot project and the successful implementation of HM, respectively, are highly socio-politically relevant since citizens are lead to no longer view tax evasion as a trivial offense. On the other hand, awareness is being raised on the part of financial authorities that, next to the law, acceptance by society is a crucial preventive mechanism for tax evasion and avoidance. Fair play and confidence-building measures can significantly contribute to decreasing the frequency of controls,

which leads to direct savings for the state. In addition, the aim of controls can be oriented more educationally and less punitive.

It is widely known that treating compliant taxpayers according to the “cops and robbers” principle leads to reactance and thus to potential future tax avoidance. A study in cooperation with the US Tax Accounting Service and the Internal Revenue Service (I.R.S.) could show that controls are a delicate measure. While they are necessary, they have to be employed carefully and well-planned (for more information see <http://www.nytimes.com/2016/06/16/business/smallbusiness/why-the-irs-fails-to-crack-the-small-business-tax-nut.html? r=1>).

Through numerous events and presentations a broad range of national and international stakeholders, including finance ministries and offices as well as firms, were informed about HM, which resulted in increased awareness of the theoretical basis and the psychological mechanisms of action of tax compliance, and thereby increased acceptance of HM. In a next step, it is planned to inform pupils at an early stage so as to reach the young people who will hold responsible positions tomorrow. Amongst others, this could be achieved in the form of Sparkling Science projects and analyses of texts in school books (determination of the status-quo and recommendations for the desired status). In addition, the economic psychology of the University of Vienna is substantially involved in the interdisciplinary Doctoral College in International Business Taxation (DIBT, <http://www.wu.ac.at/dibt>), which was founded in 2010 (supported by the FWF). The program at the interface of legal studies, tax law, economy, accounting and psychology enables an interdisciplinary understanding of mechanisms, which are relevant for international corporate tax law, and their investigation.

An economic psychology graduate is employed at the Federal Ministry of Finance since some years, which is quite an achievement since usually exclusively attorneys and economists are employed in these positions. This (slowly) developing awareness of economic psychology’s accomplishments in this field is a first important step to establish psychology in general and economic psychology in particular as an important knowledge supplier on human behavior in this kind of political activity. This is particularly important given the prevailing “superstition” that (legal) control and punishment are the only effective measures.

Quality assurance/achievement of objectives

During the pilot phase of HM in Austria, an evaluation was conducted in three assessment waves regarding the knowledge, the perception and the acceptance of HM. The aim was to investigate how firms affected by HM and those not affected as well as employees of finance ministries and offices differed in these variables. The feedback with regard to HM was continuously positive.

Whether HM will be implemented after this trial period is a political decision.

Webpage/Publications

Kirchler, E., Kogler, C., & Muehlbacher, S. (2014). Cooperative tax compliance from deterrence to deference. *Current Directions in Psychological Science*, 23(2), 87-92.
(https://www.researchgate.net/publication/261390919_Cooperative_Tax_Compliance)