Nudging Businesses to Pay Their Taxes

Reminders and a simplified language help tax authorities to collect outstanding tax payments more efficiently

Tax noncompliance harms both social cohesion and public welfare. In the US alone, tax underpayment averaged $39 billion per year from 2008 to 2010. How can tax authorities collect outstanding payments more efficiently? Novel research by RWI in cooperation with the Australian National University provides new insights: based on three natural field experiments, the researchers show that a simplified language and reminders increase tax compliance by corporate taxpayers. Early reminders are especially attractive from a tax collector’s perspective.

Contact: Mathias Sinning ➔ mathias.sinning@anu.edu.au
Katja Fels ➔ katja.fels@rwi-essen.de

Why is business tax compliance important?
Business tax compliance has always been on the political agenda, not only since the Cum-Ex Files and the Panama Papers went to press. Willful as well as inadvertent noncompliance jeopardizes public welfare: fewer tax revenues imply fewer investments in schools, roads or broadband internet. Moreover, if businesses do not pay their tax bills, individuals may be assailed by doubts whether they should meet their own tax obligations. More than that, households may perceive the whole tax system as unfair.

How do reminders increase business tax compliance?
A second study examines the effect of reminders on business tax compliance. It finds that a simple reminder letter increases the probability of payment by about 25 percentage points relative to a control group (approx. 50 percent). That is, more than 75 percent of businesses that received a reminder letter repay their debt in time. The timing of the reminder, however, has no noticeable effect. This may be due to two offsetting effects: on one hand, early reminders alert taxpayers and make them aware of possible interest penalties. On the other hand, an early reminder may also cause taxpayers to believe they will receive frequent reminders from the tax authority, hence they do not have to react on the first one. From the tax authority’s perspective, sending early reminders is preferable because they lead to earlier payments of outstanding tax debts.
Policy Recommendations

- Tax authorities should try to simplify both internal guidelines and communications to business taxpayers as far as possible. Letters should be written in plain language and be clearly structured.

- Sending reminder letters with clear instructions helps to efficiently collect outstanding tax debts.

- Further research on the effects of policy changes on the behavior of taxpayers is required. Tax collectors would benefit from being more open to conducting Randomized Controlled Trials (RCTs) in collaboration with external researchers.