How to Achieve Tax Compliance by the Wealthy: A Review of the Literature and Agenda for Policy

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Tax compliance of the wealthy determines state budgets, economic inequality, and social cohesion. Empirical evidence, however, indicates that on average the wealthy evade and avoid more taxes than do the less affluent. This might be related to the fact that the wealthy are different from average taxpayers not only in material ways, but also concerning the psychological mechanisms that determine their tax compliance. Recognizing these psychological differences, we present an innovative policy agenda that goes beyond traditional approaches, many of which are expensive and difficult to implement, such as international cooperation in closing legal tax loopholes.

The paper starts with a review of historical examples of taxing the wealthy ranging back to Ancient Egypt to convince researchers and practitioners that the status quo is changeable and that many ways exist to achieve tax compliance by the wealthy. We then examine the psychological peculiarities of the wealthy related to political-legal (macro), social (meso), and individual (micro) levels. We discuss how legal loopholes, group dynamics involving skilled tax advisors, and specific personal values associated with wealth not only impact moral reasoning and accelerate tax decisions to the unethical extreme but also make the wealthy more reactant to enforcement.

The paper then proposes a policy agenda that addresses the wealthy's psychological peculiarities with a targeted and context sensitive combination of coercive-based compulsory
as well as legitimacy-based and trust-generating soft measures. On the macro level, stricter legal environments and specialized revenue bodies are needed to replace threatening audits with neutral monitoring and relationship managers, who maintain contact and share information about the law. These new legal and administrative structures should be accompanied by marketing campaigns that inform about what is financed with taxes, utilizing positive role models to generate trust and the perception that high tax honesty is the dominant norm in society. On the meso level, stricter regulation of tax practitioners’ training is recommended, along with a professional oath like medicine’s Hippocratic oath to serve the community. Reputation tools focusing on rewards and praise for honesty rather than shaming dishonesty should be implemented together with participation tools which allow taxpayers to have voice in both administrative procedures and in the allocation and distribution of some of the own tax contributions. These trust-increasing measures should change prevailing social norms among the wealthy and their advisors, thereby counteracting social dynamics that encourage tax avoidance. On the micro-level, the specific values and motivation of the wealthy has to be acknowledged by well-trained and empowered tax auditors. Appreciation should determine the micro-level communication style, and - depending on individual values and cognitions - additional targeted argumentation should be used to reduce reactance and to represent a fair tax system that also personally benefits the wealthy.

Referring to best-practice examples from history and tax practitioners all over the world, the present review shows how specific interacting coercive-based and legitimacy-based instruments can address the psychological particularities of the wealthy with the aim of incorporating this group fully into society. This review is important to policymakers whose job is to increase compliance of these specific target groups. It is also relevant for researchers interested in cooperation, poverty reduction, inequality, and behavioural interventions in public management.