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**Research Report**

# Nudging businesses to pay their taxes

RWI Impact Notes

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RWI IMPACT NOTES
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# 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.*

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### MAIN FACTS

Business taxpayers react differently to communications with the tax authority than individual taxpayers. For businesses, it is most important that procedures are kept straightforward and simple.

A simplified language, both in internal procedures within the tax authority and in the follow-up letter to businesses, reduced businesses' tax defaults by 69 percent.

A reminder increases the probability of payment by about 25 percentage points. Early reminders are preferable from a tax collector's perspective.

### 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.

### What are the differences in businesses' and individuals' reaction to nudges?

Previous studies have shown that individual taxpayers can be positively influenced by simple changes in communications such as the color of a prompt note. For business taxpayers, on the contrary, the RWI study demonstrates that a change in font color on reminders does not increase payment rates. As businesses seem to act more rationally than households, nudges should mitigate factors that prevent businesses from complying with their tax obligations rather than targeting behavior changes by driving forces. For example, complex and time-consuming payment procedures may deter businesses from paying their outstanding tax debt. In a field experiment conducted in Australia, the RWI study finds that a simplified language in guidelines for internal procedures and in the follow-up letter sent to businesses reduces tax defaults by 69 percent.

### How do reminders increase business tax compliance?

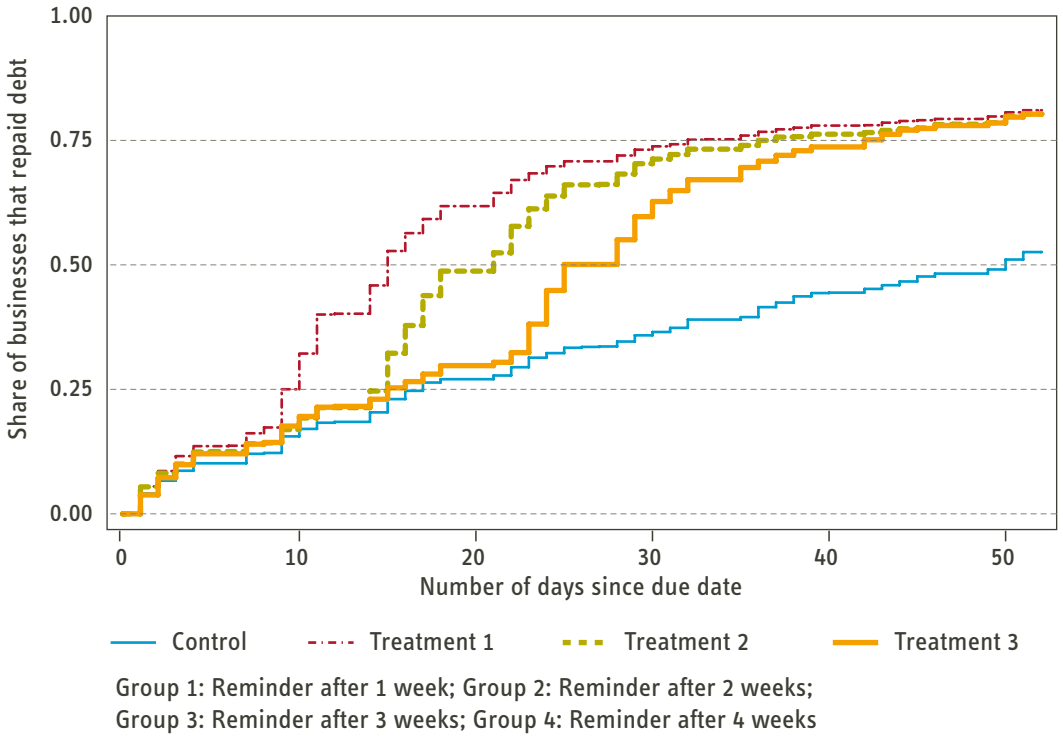
A second study examines the effect of reminders on business tax compliance. It finds that a simple reminder letter increases the probability of payment by about 25 percentage points relative to a control group (approx. 50 percent). That is, more than 75 percent of businesses that received a reminder 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.

Sources:

Gillitzer, C. and Sinning, M. (2018): Nudging Businesses to Pay Their Taxes: Does Timing Matter? Ruhr Economic Paper #760. http://en.rwi-essen.de/publikationen/ruhr-economic-papers/939/

Biddle, N., Fels, K. and Sinning, M. (2018): Behavioral Insights on Business Taxation: Evidence from Two Natural Field Experiments. Journal of Behavioral and Experimental Finance 18 (2018): 30–49. (earlier version published as Ruhr Economic Paper #698: http://www.rwi-essen.de/publikationen/ruhr-economic-papers/861/)

## Reminder letters increase the share of businesses that repay their tax debt




*Source: : Own calculations based on field data collected by the Australian Taxation Office (ATO).*

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## 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.