Can Tax Compliance be Improved through Naming and Shaming Penalty? Some Observations

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Abstract

Despite plethora of research and experiment tax compliance remains an elusive subject for the tax researchers and the tax administrations around the world. Particularly, tax compliance poses a formidable challenge for the developing countries like Bangladesh. Among the prominent theories of tax compliance deterrence theory, psychological contract theory and responsive regulatory theory are remain at the forefront. One of the less discussed theory of tax compliance is shaming theory. The article proposes that a "name and shame" non-monetary penalty could play an important role in protecting the tax system of Bangladesh by deterring the tax delinquents. The article argues that tax compliance can be improved through shaming and naming of the recalcitrant taxpayers who have tax debt. It is also argued that shaming is effective in creating inner motivations and feeling of guilt who do not report income to the tax authority. If not in its totality, the theory can be resorted to by the income tax administration of Bangladesh as an effective tool to ensure voluntary compliance by the taxpayers.

Keywords: Tax Compliance, Theories of Tax Compliance, Shaming Theory, Income Tax Department, Bangladesh.

Part I: Introduction

Despite plethora of research and experiment, tax compliance remains an elusive subject for the tax researchers and the tax administrators around the world. Particularly, tax compliance poses a formidable challenge for the developing countries like Bangladesh. To address the challenge of tax non-compliance different theories and models have been put forward by the tax researchers. Among the prominent theories of tax compliance deterrence theory, psychological contract theory and responsive regulatory theory are remain at the forefront. One of the less discussed theory of tax compliance is shaming theory. This theory is an offshoot of psychological theory of tax compliance. According to this theory naming and shaming of the tax evaders deters the taxpayers to indulge in non-compliance. The purpose of this article is to critically discuss the shaming theory. It is argued that if not in its totality, the theory can be resorted to by the income tax administration of Bangladesh as en effective tool to ensure voluntary compliance by the taxpayers. The article is arranged as follows. Part I of the article gives an introduction while part II briefly delineates some of the major compliance theories that contributed to the field of research with tax compliance. Part III critically discusses the effectiveness of the shame and guilt theory in curbing the problem of non-compliance by examining the current body of literature on the subject. Part IV makes some concluding remarks.

Part II: Major Tax Compliance Theories

There is no one-size-fits-all approach to address the problem of tax non-compliance (Brockmann et al, 2015). Over the years, researchers proposed different models and theories in an attempt to deal with the tax compliance problem. Tax compliance issue remains a debated issue from the early stage of the civilization when the concept of taxation was in its embryonic stage (Gitaru, 2017). The main theories of tax compliance have been categorized into two groups. One is the economic deterrence theory and the other one is the social-psychological theory that puts emphasis on tax morale and the behavioral aspect of tax compliance. There are again different subdivisions of the two main theories. One of the prominent theories that belongs to the social and fiscal psychological theory of tax compliance is the shaming theory. Tax compliances theories proffer interesting explanations regarding tax compliance behavior. For example the economic deterrence theory as propounded by Becker (1968) argues that taxpayers comply because of the apprehension of being caught and penalized in case of tax evasion. The theory considers taxpayers as rational animals. The taxpayer gambles with the probability of detection. If she thinks that there is less chance of detection, she goes for tax evasion. The taxpayers calculate the cost benefit aspect of her tax evasion behavior. If the benefit derived from tax evasion seems to surpass the punishment for evasion, the taxpayer is encouraged to evade tax. The theory necessitates proper enforcement by tax authorities like tax audit, strong third party reporting regime, volume of pecuniary penalty etc. Based on the theory Allingham and Sandmo (1972) developed a model where they showed that the taxpayer adopts the strategies that offer him maximum benefit. Allingham and Sandmo (1972) argue, "The tax declaration decision is a decision under uncertainty. The reason for this is that failure to report one's full income to the tax authorities does not automatically provoke a reaction in the form of a penalty. The taxpayer has the choice between two main strategies: (1) He may declare his actual income. (2) He may declare less than his actual income. If he chooses the latter strategy his payoff will depend on whether or not he is investigated by the tax authorities. If he is not, he is clearly better off than under strategy (1). If he is, he is worse off. The choice of a strategy is therefore a non-trivial one." The theory involves tax administrations' aim at ensuring compliance through enforcement consequently ensuring the ability to pay principle which in turn ensures fairness of the tax system (Chauke and Sebola, 2016). After Allingham and Sandmo, the theory was later extended by Yitzhaki (1974). The theory however, offers partial explanation of tax compliance behaviour. Fear of detection and punishment do not always propel compliance. For, Alm et al (2010) argued that the question should be to ask why people comply rather than why taxpayers do not. Besides, as Phillips (2011) argues that, "…taxpayers do not face a constant likelihood of audit and noncompliance detection; instead, the probability of audit and detection depends on the taxpayer's noncompliance itself."

As opposed to the economic deterrence theory, the social and psychological theory of tax compliance puts emphasis, not on profit maximization. Rather the theory gives preference to individual attitudes and belief of the taxpayers that emanate from inner self as a response to social norm. Kepulu et al (2016) state, "The essential thrust of this theory is that individuals are not simply independent utility

maximizers, rather individuals are recognised to exhibits an array of attitudes and beliefs which interact and respond to social norms. This model inductively examines the attitudes and beliefs of taxpayers to understand and predict human behaviour." Jackson and Millirons (1986) argued that social cost of sanctions can be far more than the statutory audit and penalty. Researchers like Schmolders (1959), Strumpel (1969), Spicer (1974), Vogel (1974), Song and Yarborough (1978), Ajzen and Fishbe in (1980), Erard and Feinstein (1994); Harold, Grasmick, and Bursick (1990) and many others contributed to develop the theory by explaining multiple aspects of human behaviour and attitude.

Part III: Shaming Theory of Tax Compliance

This section is divided into two parts. The first part discusses the shaming theory as it is meant and understood as a tool to generate feelings of guilt for not reporting income to the tax authority. The second part would deal with the issue of tax debt collection by using shaming and naming of the recalcitrant taxpayers who owe to the tax department.

i. Shaming Theory as an Offshoot of Social and Psychological Theory of Tax Compliance

Shaming theory of tax compliance is an offshoot of social and psychological theory of tax compliance. This theory suggests that shaming the tax evaders or recalcitrant taxpayers should work to improve voluntary compliance. Shaming has social costs and it puts stigma on the taxpayers. The theory is being suggested in case of environmental degradation issues and combat climate change (Taebi and Safari, 2017). In China, the government uses shaming and naming by publishing the names of the debtors and banning them from flying, buying train tickets, and staying at luxury hotels (Chan, 2017). Though theoretically, having ambiguous impact on tax compliance behaviour, Dwenger and Lukas (2018) found through empirical studies in Slovenia that individual and corporate taxpayers' compliance improves significantly as a result of shaming although for financially jeopardized taxpayers the effect is insignificant. Dwenger and Lukas (2018) state, "The threat of shaming is effective at increasing compliance and at enforcing tax payments which were considered uncollectable with standard enforcement instruments. This suggests that social pressure and social image concerns are important determinants of tax compliance." Togler (2003) suggests, "The sentiments guilt and shame may influence reporting behaviour, reducing the perceived benefits of cheating." Public shaming tarnishes the image of the taxpayers and that creates guilty feelings and acts as deterrent from within the mind of the taxpayer. Lewis (1971) states that shame makes a person to experience in a way that some inner entity is abhorring or ridiculing the self (Cited in Torgler, 2003). Torgler (2003) argues, "Since the obligation of paying taxes to the government is an accepted social norm, it makes sense that individuals who choose not to pay all of their taxes may feel guilty." Indeed reporting of income and payment of taxes are legal obligations as determined by the body politic in taxing statute. So if someone does not do so, it should be normal that she feels guilty for not complying with the legal obligation of complying with the tax laws. So this inner feeling of guilt and shame should drive the taxpayers towards voluntary compliance. Torgler (2003) cited from Aitken and Bonneville (1980) who found through taxpayer survey that taxpayers surveyed felt guilty where they understated income, did not file tax return, overstated expenditures etc. Survey research also found that the anticipated guilt of tax evasion can work as a deterrent (Grasmick and Bursick, 1990 cited in Torgler, 2003). Jensen and Wöhlbier(2012) suggest, 'Non-monetary sanctions such as "name and shame" methods which include the publication of the names and relevant information of delinquent taxpayers can be used to increase the cost of non-compliance in cases where monetary sanctions are not adequate to discourage taxpayers from non-compliance.'

Although shame and guilt theory can play an important role in combatting the problem of non-compliance it has its weak point in that shame and guilt is not directly observable pehmenon and it cannot be deduced from economic or psychological theory how guilt and shame impacts the utility function (Torgler, 2003).

ii. Naming and Shaming the Tax Debtors

Naming and shaming strategy is nowadays being used to collect tax debt from taxpayers who are reluctant to pay their tax bill. Tax debts have become a central problem for the tax administrations of both developed and developing countries (Cranor et al, 2018). Shaming and naming is considered as a non-pecuniary penalty that is imposed on delinquent taxpayers to collect tax debt owed to the tax department. This can be considered as soft or psychological deterrence as opposed to the economic deterrence theory. Shaming penalty is imposed on the tax debtors by publishing their names in public (Perez-Truglia and Troiano, 2015).

Tax debts, if properly collected provide ready source of revenue. Tax debts can be owed by the individual tax payers and corporate tax payers. Again corporate taxpayers can owe corporate tax and also tax deducted at source on account of payment for supply of goods and services and others as is the law under the Income Tax Ordinance, 1984. However, countries like the USA and Brazil use public shaming to collect tax debts from the delinquent taxpayers. Approximately, half the US states, including California, Florida and New York, publish online lists naming and shaming tax delinquents (Luttmer and Singhal, 2014). The public shaming of delinquent taxpayers is becoming popular gradually around the world. Veuger (2015) states, 'The idea is that once people realize that their friends and neighbors may see that they are not paying their taxes, they feel embarrassed and pay up. What these endeavors attempt to do is to replicate and scale up the sense of community that facilitates resolving collective action problems at the local level.'

The shaming system varies from country to country. For example, the US states publish the list of tax debtors. In the Indian state of Bangalore drummers play their drums in front of homes and offices to embarrass the taxpayers who refuse to pay their tax debts (Le Beau, 2018). The Croatian tax department publishes list of the tax delinquents from time to time and uses naming and shaming to collect tax debts (Marjanovi, 2018). In 2017, the Croatian Tax Administration collected tax debt to the tune of HRK 564 million from the taxpayers from the shaming list. US State California regularly publish list of tax delinquents. State of California Franchise Tax Board website contains an up-to-date list of tax delinquents. The Australian Taxation Office (The ATO) send the list of small business tax debtors to the credit agencies. As of June 2016, the ATO had arrear tax debt to the tune of AUD$19.2 billion and it was under mounting pressure from the government to collect the same. Consequently, the ATO adopted the naming and shaming policy (Rossi Legal, 2017).It is to be noted that naming of delinquent tax payers started in Australia, in federal Australian tax history in the Second Annual Report of the Commissioner of Land Tax (1911-12). In the annual report sixteen taxpayers were named in Schedule No. 8 who were prosecuted for persistent neglect not lodging returns persistently. The system of naming and shaming continued in Australia for over 70 years and since 1984-85 ATO stopped naming the delinquent taxpayers in the Annual Reports.

In the Indian state of Bihar, eunuchs are sent to the shopkeepers who sing shameful songs before them for not paying their tax debts. The eunuchs were given 4% of the tax collected (BBC News, 2006). South Africa Revenue Authority publishes the names of tax delinquents and taxpayers who fail to submit their tax return. This is done to ensure compliance through naming and shaming (Omarjee, 2018). In the United Kingdom, HMRC publishes the list of delinquent taxpayers. Section 94 of the Finance Act, 2009 authorizes the HMRC to publish information about a deliberate tax defaulter where after investigation the taxpayer has been charged with one or more penalties for deliberate defaults and those penalties involve tax of more than £25,000 (GOV.UK, 2010). Names are published once the penalty imposition is final. In Argentina local governments use naming and shaming to collect taxes (Perez-Truglia and Troiano, 2015). South Korea also publishes list of taxpayers who fail to pay their taxes. In 2016, the published list revealed that more than 6,000 companies and 15,000 individuals failed to pay taxes amounting to $10.4 billion. South Korea started naming and shaming tax delinquents from 2006 (Chan, 2017).

iii: Does Shaming Work?

It is really a big question whether naming and shaming works in combatting tax evasion and avoidance and to what extent it is effective in collecting tax debts. Perez-Truglia and Troiano 2015 observed through survey research that taxpayers who owe tax debt below 2500 dollars pay the bill due to shaming and naming, not the big tax debtors. The researchers concluded that the reason why big tax debtors do not pay their tax debt even if they are named and shamed, might be that to what extent they are willing to spend to save their reputation. The argument sounds logical when one IRS official states, "When you are talking about large debts, you do tend to get some people who just don't care. It's just not worth paying off their $450,000 or $1.2 million debt. Down on the lower levels, you get more of the Average Joe who is concerned." (Cited by Le Beau, 2018). Coricelli et al (2010) found through experiment that making the tax cheaters name public can reduce the probability of cheating by 8.20 percent. Coricelli et al (2010) suggest inter alia , '…a policy threatening to denounce cheaters publicly with a reduced amount of fines- i.e. augmenting the emotional cost and reducing the monetary cost-might be more effective.'

Of late naming and shaming has become familiar in the wake of tax evasion by multinational corporations like Google, Amazon, and Starbucks. The recent aggressive tax planning to avoid tax by the multinational corporations has caught public

attention. These MNCs have been named and shamed publicly. For example Google, Amazon and Starbucks have been criticized by the United States Public Accounts Committee for tax avoidance. MNCs like Starbucks is changing its arrangements and has decided to pay UK corporation tax. Because of shaming of the MNCs, customers are boycotting the big brands as a token of protest against tax avoidance (Barford and Holt, 2013). The world community and the tax administrations around the worlds seem to be aware regarding tax avoidance by the big MNCs. This is due to shaming and disclosure of their aggressive tax planning. So it is evident that when information regarding tax avoidance is disclosed it amounts to shaming and this disclosure has positive impact on the tax compliance behaviour of the large corporations. However, the impact of shaming is not observed since disclosure regarding individual taxpayers' tax evasion or avoidance is not found.

Devos and Zackrisson (2015) argue that disclosure so far has been made of the MNCs tax planning, but no disclosure about individual taxpayers. Perez-Truglia and Ugo Troiano (2015) argue, 'But many people worry that the publication of the lists could backfire by insulting individuals who are in temporary financial hardship, making them less likely to pay once they are back on their feet. Or the shaming could alienate delinquents from future sources of income that could have been used to pay up.' Shaming can be considered coercive by the taxpayer which in turn can debilitate the trust of the taxpayers on the tax department. Paris (2015) says, 'If an agency exercises too much coercive power in relation to its exercise of legitimate power, the agency's use of that power will be viewed as unfair and oppressive. As a result, taxpayer trust in the agency will suffer and overall levels of compliance will decrease. To be effective in promoting compliance… coercive power should be used only in limited circumstances. 'Coricelli et al (2010), argue, 'Further research is however needed to explore the potential backfiring effects of a public exposure of deception. Indeed, once their reputation is lost, evaders may react by evading even more.'

Part IV: Naming and Shaming by Income Tax Administration of Bangladesh

Recently Bangladesh graduated as a middle income earner country. Foreign aids are no more available for Bangladesh. The country has to rely on its internal resources to develop the economy. So at this juncture, Bangladesh needs to gather huge amount of tax revenue to meet up the government expenditure. But Bangladesh taxation system is characterized by narrow tax base, widespread tax evasion and avoidance. Tax GDP ratio is one of the lowest in the region. Tax culture is very poor. The National Board of Revenue (NBR) is struggling to achieve the budget target for reasons more than one. A huge amount of revenue cannot be collected due to, partly taxpayers' negative attitude and also poor enforcement effort on the part of the NBR. According to (NBR), unpaid, undisputed and collectable tax debt stands at tk 12181. This amount represents income tax debts. If indirect tax like VAT is considered the amount should be much higher.

NBR is trying hard to improve the state of compliance in terms of reporting of income and collection of tax debts. But the picture is not encouraging. Under the circumstances it is suggested that if the NBR, particularly the Income Tax Department of Bangladesh (ITDB), along with other enforcement strategies, adopts the naming and shaming penalty policy, the state of poor compliance should be improved to the expected level. In doing so Bangladesh can follow other countries and craft a naming and shaming regime that does not cause motivational postures among taxpayers frightening them to keep away from the tax authorities. Such naming and shaming can create mistrust, anger, defiance on the part of the taxpayers ultimately affecting compliance in a negative way.

So what is sine qua non for the adoption of such a non-pecuniary penalty system is that the tax administration should think about the legal implications of such a measures. In a country where tax culture is very poor (Ahmed, 2018) and people are less prepared to defer to the tax authority and where people consider tax as a threat, such naming and shaming can yield negative result. So to implement naming and shaming regime issues like necessary legal coverage, response from the stakeholder should be taken care of.

Naming and shaming must be within the framework of law. Income tax law prohibits the publication of taxpayers' information. So if this shaming penalty is to be used then it must be inserted in the taxing statute preferably for a certain period of time. If this is done hopefully tax culture will be improved in the Bangladesh. In this respect a committee can be formed to examine the probability of making such penalty regime. The committee should study the laws of other countries that provide for such shaming and naming penalty. As mentioned earlier the UK HMRC publishes the list of tax delinquents by virtue of section 94 of the Finance Act, 2009. Californian

Franchise Tax Board has the legal authority to publish top 500 names of tax delinquents every year. Their action was declared by the court as constitutional.

Before implementing shaming regime, the NBR should conduct a survey or empirical research on the topic whether it would be apt for Bangladesh to go for such a penalty regime. If proper research is not done and the programme is implemented, it might yield negative results by creating motivational postures among the taxpayers. The named and shamed taxpayers might keep a distance from the tax department as a result of the shaming process. There might be some political implications for such type of regime. So all these issues should be considered and carefully examined before making such a law.

Part V: Conclusion

Although taxpayers' identity is important and confidential as per taxing statutes, disclosure is made regarding tax delinquents through shaming and naming. This is an enforcement regime which is not normally adopted by the tax administrations. But the countries that used naming and shaming disclosure of tax delinquents, got positive results. The article argues that naming and shaming can be a good way for Bangladesh tax administrations to collect undisputed arrear taxes, both direct and indirect. This in turn would probably improve tax compliance. Research in this field is not adequate and in Bangladesh there is no study in Bangladesh. So further empirical research is necessary to shed light on the effectiveness of naming and shaming penalty on tax compliance.

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