

Thwarting cheaters with 'smart' tax returns

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Research by the University of Michigan examines whether changes to the income tax return could help cut evasion, which costs federal, state and local governments more than \$400 billion a year.

Methods used to prevent [tax evasion](#) are often expensive or politically unpopular, so is it time to modernize the tax return itself? U-M economist Joel Slemrod thinks so.

His new study suggests techniques from social psychology and e-commerce could both reduce tax evasion and make the process easier for everyone. It's co-authored by Joseph Bankman and the late Clifford Nass of Stanford University.

"The idea is to use words and questions that tend to steer people toward moral behavior and increase their psychological cost of lying," said Slemrod, professor of business economics at the Ross School of Business and professor of economics at the College of Literature, Science, and the Arts.

The first suggestion he and his colleagues make is a simple one—force cheaters to lie by commission rather than omission. Direct yes-or-no questions on paper and electronic forms would force taxpayers into making clearly true or clearly false statements.

Requiring an attestation of truth before filling out a return could also prod people into honest behavior.

More detailed, direct questions about sources of income on tax forms—instead of just leaving a space to fill in—also forces people to think twice about entering false or incomplete information.

"Social science has shown that active lying has a higher psychological price than simply omitting information," Slemrod said. "These wording changes would cost virtually nothing and have the potential to reduce evasion and increase revenue."

Another way to nudge people toward honesty is a technique used by online retailers such as Amazon—data-driven, adaptive systems that can ask individualized questions.

All current tax forms ask the same questions. But research shows certain types of taxpayers are more likely to underreport or omit taxable income. Adaptive systems can be used to analyze a taxpayer's past filings and ask only more relevant questions.

While a more complicated solution—and one that should be implemented with care—if handled correctly, it could make [tax](#) filing easier for everyone and boost revenue. Pilot programs could test the impact of such changes before rolling them out to all taxpayers.

"There is something Orwellian about being asked intrusive questions by a computer," Slemrod said. "Filing taxes is already an unpleasant interaction with the government. But if the system can ask more targeted questions, the IRS could improve compliance with fewer questions and reduce the number and cost of audits."

More information: "Using the 'Smart Return' to Reduce Tax Evasion." Stanford Public Law Working Paper No. 2578432. papers.ssrn.com/sol3/papers.cfm?abstract_id=2578432

Provided by University of Michigan

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