The Role of Behavioral Incentives and Punishments in Promoting Tax Compliance

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Abstract- Public finance is an important aspect of tax compliance since it makes sure that a government has revenues needed to finance the supply of goods and services. Nevertheless, non-compliance in taxes remains to be a significant issue in most countries which causes a huge disparity between the potential and the actual tax revenue. The tax gap in Australia has been estimated at about 7.5 percent of the prospective total available tax revenue which estimates about 44.5 billion in the 2021-2022 financial year. This research paper examines how behavioral incentives, social norms, and the compliance costs affect tax compliance behavior by taxpayers. A quantitative survey-based research design was adopted, and an online questionnaire was administered to Australian taxpayers. Qualtrics was used to obtain data, which comprised 311 participants, and a final sample of 299 respondents was analyzed following the data cleaning process. The correlation analysis of Pearson and ordered logit regression were employed to assess the determinants of tax compliance using descriptive statistics. The results show that social norms have a significant effect on tax compliance behavior which is positive whereas compliance costs have a negative effect on compliance. Rewards and fines were identified as behavioral incentives that did not have statistically significant effect on behavior in terms of compliance behavior. The paper shows that sociopsychological factors are essential in encouraging voluntary compliance with taxes, and governments should consider the use of behavioral nudges and simplify tax regimes so that compliance is less expensive.

Index Terms- Tax compliance, behavioral incentives, social norms, compliance costs, taxation policy.

I.   INTRODUCTION

Taxation is the pillar of government income, and it is important in funding the provision of government services and goods like healthcare, infrastructure, education and security. Taxes play a critical role in maintaining economic development and social welfare systems by the governments. Nevertheless, complete tax compliance by taxpayers has continued to be a challenge in both the developed and developing economies.

In Australia, the Australian Taxation Office (ATO) has indicated that in the 2021-2022 tax year, the net tax gap data showed that the total potential tax revenue was estimated at about 7.5 percent, equivalent to an amount of about 44.5 billion of uncollected taxes. This loophole is an indication of the persistence of tax non-compliance, such as tax evasion, underreporting of income, and failure to file tax returns on time (Australian Taxation Office (ATO), 2024).

Conventionally, tax authorities have tried to enhance tax compliance by using tax enforcement tools like fines, penalties and audits. The main assumption that underlies these measures is that taxpayers are rational and will obey tax laws in cases where the penalty of disobedience is larger than the probable benefits of evasion.

Recent events in the field of behavioral economics however indicate that economic factors do not only play a role as to why the taxpayer makes the decisions they make. Rather, psychological and social reasons also hold significant contributions to the behavior of tax compliance. As an example, people are willing to obey the tax laws either because they feel that this is a moral duty or because they think that other people in the society are doing the same or because society is obliging them to do it.

Tax compliance behavior is influenced by three significant factors, which include behavioral incentives, social norms, and compliance costs. Rewards and penalties are behavioral incentives that are aimed at motivating taxpayers towards obeying the rules

of the tax law. Social norms are social expectations and peer pressures which influence the behavior of individuals. Compliance costs are the administrative and financial level of meeting the tax requirements (Cahyonowati et al., 2022; Cahyonowati et al., 2023).

Knowledge of the role played by these factors is important in the process of formulating effective tax compliance strategies by the policymakers. Thus, the research paper explores determinants of tax compliance behavior through the impact of behavioral incentives, social norms and compliance costs among the Australian taxpayers.

This study contributes to the tax compliance literature by providing empirical evidence on the relative importance of behavioural incentives, social norms, and compliance costs. It further extends prior research by examining the interaction between behavioural incentives and social norms in the Australian context.

II.   LITERATURE REVIEW

A.   Behavioral Incentives and Tax Compliance

Behavioral incentives are policy instruments that are used to change behavior in individuals either by rewards or punishments. Taxation The taxation system can create incentives, such as tax credits, tax rebates, and other incentives that taxpayers must adhere to tax rules.

According to the financial exchange theory, taxpayers are more likely to obey the tax rules whenever they feel that they are benefiting through government spending. When taxpayers perceive that their taxes purchase valuable services to the community, they will have more reasons to pay their taxes(Bărbuţă-Mişu, 2011; Mahangila, 2017; Antinyan & Zareh, 2020; Mebratu, 2024).

The other influential model is the economic deterrence model which opines that rational decisions are made by taxpayers who compare the gain of evading taxes and the possible costs of being found and punished. This model suggests that an increase of penalties and probabilities of audits would deter tax evasion.

Nonetheless, the results of the research on behavioral incentives are inconsistent. It has been found that rewards and penalties can enhance tax compliance, and it has also been proposed that overuse of punitive measures can lead to a lack of trust in the tax system and discourage voluntary compliance.

B.   Survey Presentation Disclosure and Reporting.

Social norms are influential in determining the behavior of people in each society. Humans tend to respond in a certain way depending on the behavior they see in others.

About taxation, social norms affect taxpayers by creating perception that majority of the people in society will abide by the tax laws. When taxpayers feel that those around them and peers are paying taxes in an honest manner then they will tend to do the same.

Nudging strategy as an intervention to reinforce social norms and promote tax compliance has been suggested by behavioral economists (including social comparison messages and reminder letters). Take, as an example, the efforts of the government to instill in the taxpayers the sense that most people in their community are paying their taxes on time, and this may influence them to similarly keep the same behavior.

C.   Compliance Cost and Tax Compliance.

Compliance costs are the financial, administrative and time costs that are used on the compliance with the tax laws. Such expenses can involve the employment of tax experts, the keeping of financial information and knowledge of difficult tax regulations.

Compliance costs may be very high; this may demoralize taxpayers to pay their taxes. The complicated tax structures usually demand professional help from the taxpayers, thereby raising the compliance cost (Mebratu, 2024).

Research has revealed that tax compliance can greatly be enhanced by tax simplification and making the tax processes less complex. The governments can do this by implementing digital tax filing systems, easing taxation regulations and giving precise directions to the taxpayers (Alm, 2018; Antinyan & Zareh, 2020; Mebratu, 2024).

III.   RESEARCH METHODOLOGY

A.   Research Design

This research was quantitative survey-based research that was conducted to research the determinants of tax compliance behavior among Australian taxpayers. Quantitative approach was considered suitable since it enables the researcher to analyze the relationship between variables, using statistical methods and give objective and measurable outcomes.

The rationale for using a quantitative survey design is to examine the relationship between behavioral incentives, social norms, compliance costs, and tax compliance behavior. (Cahyonowati et al., 2022). The survey design of this study enabled the researcher to examine the relationship between behavioural incentives, social norms, compliance costs, and tax compliance behavior.

Moreover, quantitative research design is popular among studies involving taxation and the policy of the state as they offer trustworthy and repeatable results. Through the use of statistical analysis methods, the research could determine patterns and relationships between independent variables and tax compliance behavior.

B. Participants

The respondents were 311 Australian taxpayers who were between the ages of 18 and 60 years. This age bracket was chosen due to the fact that they are the working age group who must file an income tax on a regular basis. The age group out of 60 and above was filtered since most of the individuals in this age group are retired and might not have the same tax burden as the working population.

The respondents were identified through the convenience sampling technique that enabled the researcher to gather the responses in the most efficient way within a short time frame. The survey link was shared via online networks whereby people could join at their will. The participants were also motivated to spread the survey to others in their circles of friends in order to get more responses.

Data cleaning and filtering of incomplete responses were then performed after which 299 valid responses were incorporated in the final dataset. Incomplete responses and responses with incongruent information were eliminated to guarantee reliability and accuracy of the analysis.

The demographic difference present among the participants offered valuable information about the perception of taxpayers as well as their behavior in matters pertaining tax compliance in the Australian context.

C. Data Collection

An online survey conducted on the Qualtrics online service was used to collect the data between 13 May and 20 May 2025. The online surveys were selected as the main data gathering package since it enables the researcher to gather data on a substantial number of respondents within a relatively brief duration of time.

The questionnaire contained 27 questions which were separated into five sections and each section represented the key constructs connected with the tax compliance behavior. These sections entailed tax compliance, reward incentives, deterrence incentives, social norm, and compliance costs.

The questionnaire was to be measured on a five-point Likert scale (strongly disagree, strongly agree, 1-5). This was a measurement scale whereby the respondents were able to formulate their perceptions and attitude towards tax compliance behavior in a systematic way.

Participants had an information sheet that contained a description of the aim of the study before filling in the survey. They were told that as they were involved in the studies, it was voluntary and all the responses would be anonymous and confidential. The participants were also guaranteed that their answers would be utilized as academic research.

D. Data Analysis

Descriptive statistics, Pearson correlation analysis, and ordered logit regression modelling were used to analyze the data collected. Statistical methods were applied to the study of the links between these independent factors and tax compliance behavior.

Basic characteristics of the dataset were summarized by using descriptive statistics. It involved the computation of average, standard deviation, minimum values and maximum values of each variable.

The Pearson correlation test was carried out to investigate the direction and strength of the correlation between the variables that were involved in the study. The analysis assisted in establishing the relationship between variables like social norms and compliance costs and whether they are positively or negatively related to tax compliance behavior.

Lastly, the determinants of the tax compliance behavior were analyzed using ordered logit regression. The reason why this model was selected was that the dependent variable of tax compliance is an ordered categorical variable that had low, medium, and high levels of compliance. Ordered logit model is very common in social sciences studies where dependent variables have several categories which are ordered.

IV.   RESULTS

A. Descriptive Statistics

The descriptive statistics data shows that respondents may find it noteworthy that the tax compliance levels were relatively high. The average score of 4.13 of the participants in respect to tax compliance implies that majority of the participants concurred with statements reflecting on responsible tax behavior.

Another descriptive finding is that the respondents rated moderate levels of behavioral incentives and social norms in the Australian tax system. Several of the respondents maintained that they think tax compliance is a normal and socially responsible behavior that has been adopted by most citizens.

In addition, respondents gave ambivalent views on the compliance costs. Although there were participants who thought that the process of filing the tax returns is relatively easy, some also stated that the tax system may be complicated and time consuming. In general, descriptive statistics give a rough idea of the perceptions of the taxpayers concerning tax compliance and other associated variables.

Variable	Min	Max	Mean	Std. Deviation
Tax Compliance	2	5	4.13	0.56
Reward Incentives	1	5	4.22	0.77
Deterrence Incentives (Fines and Penalties)	1.8	5	3.72	0.55
Social Norms	1.4	5	3.89	0.69
Compliance Costs	1	5	3.41	0.91

B. Correlation Analysis

The correlation study was done to explore the associations between tax compliance and the independent variables that were used in the research. The findings indicated that there was a positive strong relationship between social norms and tax compliance behavior. This discovery implies that people tend to adhere to tax laws more when they feel that other people in society adhere to the tax laws.

Conversely, the tax compliance was negatively related to compliance costs. This implies that the increased administrative and financial costs incurred during the filing of taxes make the taxpayers less likely to meet the tax regulations.

The review also established that the behavioral incentives like rewards and penalties were moderately weak in relation to tax compliance behavior. This indicates that the role of these incentives in shaping the behavior of taxpayers may not be as significant as it was earlier presumed.

Variable	Tax Compliance	Significance (ρ-value)
Reward Incentives	0.0555	0.3416
Deterrence Incentives (Fines and Penalties)	0.4943***	0.8022
Social Norms	0.1897***	0.0000
Compliance Costs	0.0146	0.0010

C. Regression Analysis

The ordered logit regression analysis was done to take a further look at what factors determine tax compliance behavior.

The findings suggest that social norms play a great positive role in influencing tax compliance behavior. This implies that taxpayers will tend to follow the rules of tax regulations more when they feel that other members of their social setting are also following these rules.

The analysis also found that compliance costs significantly impact negatively on tax compliance behavior. Taxpayers who view the tax filing as difficult, expensive or time-consuming have lower chances of meeting tax filing requirements completely.

Notably, the findings also indicate that behavioral inducement like rewards and fines are not significant to induce change in tax compliance behavior. This observation indicates that conventional enforcement systems might not be as good as behavioral and social issues in encouraging tax compliance.

Variable	Estimated (β)	Sig. (ρ-value)	UCI	LCI
Reward Incentives	0.050	0.904	-0.760	0.860
Deterrence Incentives (Fines and Penalties)	-0.180	0.750	-1.289	0.929
Social Norms	1.627***	0.002	0.598	2.656
Compliance Costs	-0.427***	0.009	-0.746	-0.107
Interactions (Social Norms and Incentives)	-0.004	0.881	-0.062	0.053

V.   DISCUSSION

The results of the current study are useful in understanding how behavioral and economic problems can be used in determining tax compliance behavior. Among the most significant findings, the importance of social norms as the factors of shaping the taxpayer's behavior must be mentioned.

The social influence theory confirms the social effect of social norms which propose that people are more likely to adhere to the behavior and expectations of their social groups. Taxpayers will tend to act in the same manner when they feel that their peers, colleagues and fellow members of the family follow the tax regulations.

These findings imply that the governments should think about employing such behavioral interventions like social comparison messages, reminders, and awareness campaigns to reinforce social norms and achieve voluntary tax compliance.

The other significant study finding is that compliance costs have a negative effect on tax compliance behavior. The introduction of complicated tax systems and administration may dishearten people to pay their taxes.

The policy makers should thus consider how to simplify the tax procedures, enhance the tax administration systems as well as how to minimize compliance costs. Digital tax filing systems and simplified taxation regimes can be of great value in improving taxpayer compliance.

VI.   CONCLUSION

This paper analyzed how the behavioral incentives, social norms and compliance costs affect tax compliance behavior among the Australian taxpayers.

The results show that the social norms have a great influence in promoting compliance to tax and compliance cost detracts compliance behavior. Rewards and penalties as behavioral incentives were not discovered to play a significant role on taxpayer behavior.

These findings imply that the behavioral approaches and simplification of the taxation system are among the priorities of the policymakers who wish to enhance voluntary adherence to the taxation system (Jimenez & Iyer, 2016; Cahyonowati et al., 2023).

Through consideration of the behavioral insights in designing tax policies and diminishing the administrative costs of tax filing, governments can enhance the tax compliance rates and decrease tax gaps.

Some other factors like trust in institutions of government, perceived fairness of taxation systems and education of taxpayers should also be studied in future because these variables might contribute further to tax compliance behavior.

APPENDIX

Tax Compliance (TC)

I often submit my personal income tax returns to the ATO on time. I estimate my annual income tax returns correctly.

I do not try to reduce my tax liability when estimating my income tax returns. Even if there were no tax audits, I would still estimate my income tax returns accurately. I believe it is my duty as an Australian citizen to pay my income taxes on time.

I believe paying my tax obligations is the right and natural thing to do.

Reward Incentives (RI)

I believe tax rewards, such as tax credits, could motivate me to pay taxes on time. I believe citizens should be rewarded for being tax compliant. A tax reward scheme will make me feel like I am being appreciated for being tax compliant.

The availability of tax credits and other tax incentives motivate me to pay taxes on time. A tax reward scheme with personal and medical reliefs encourages me to pay taxes on time. I am motivated to accurately estimate my annual income tax returns if taxes are used to offset my mortgage obligations.

Social Norms (SN)

It is important for me to be perceived as a responsible citizen who pays taxes promptly. I find it socially unacceptable to reduce/evade my income tax liabilities when filing returns.

I believe other Australian citizens are compliant with their income tax obligations. I am encouraged to pay my taxes promptly if other family members and friends also do so. Filing tax returns and paying taxes promptly is a normal and responsible behavior.

Compliance Cost (CC)

Estimating annual income tax returns in Australia is complex and costly. When filing returns, the burden of record-keeping and complying with tax regulations is costly.

When filing income tax returns, seeking the services of tax consultants and agents is expensive. Lodging annual income tax returns in Australia is complicated and time-consuming. Understanding income tax legislations in Australia is complex and costly.

Fines and Penalties (FP)

I feel that the ATO's late filing and late payment fines or penalties are severe. I believe that the ATO's fines and penalties for late filing and late payment are excessive but fair.

I file my income returns on time and pay taxes promptly to avoid fines and penalties by the ATO. I believe reasonable fines and penalties encourage citizens to be responsible in paying taxes. I believe most Australians comply with tax regulations to avoid tax fines and penalties.

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