

The long-run and network effects of enquiries

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Key aims

This project aims to address two questions:

1. How long-lasting is the effect of an audit on audited taxpayers?
2. What is the effect of an audit on non-audited taxpayers in the same network as audited taxpayers?

Motivation

The ongoing drive for a more efficient public sector increases the importance of understanding what determines tax noncompliance and of effective strategies to identify and recover revenue from noncompliant taxpayers.

Previous work by HMRC has shed some light on how long-lasting the effect of audits are. We will build on this, aiming to tighten the conclusions by using more data and improved techniques. We also hope to use HMRC's powerful "Connect" tool to demonstrate the role of taxpayer networks in compliance decisions.

Methodology

Here we focus on question (1) above. To establish the effect of audits on behaviour we need a way to estimate how taxpayers would have behaved in the absence of an audit.

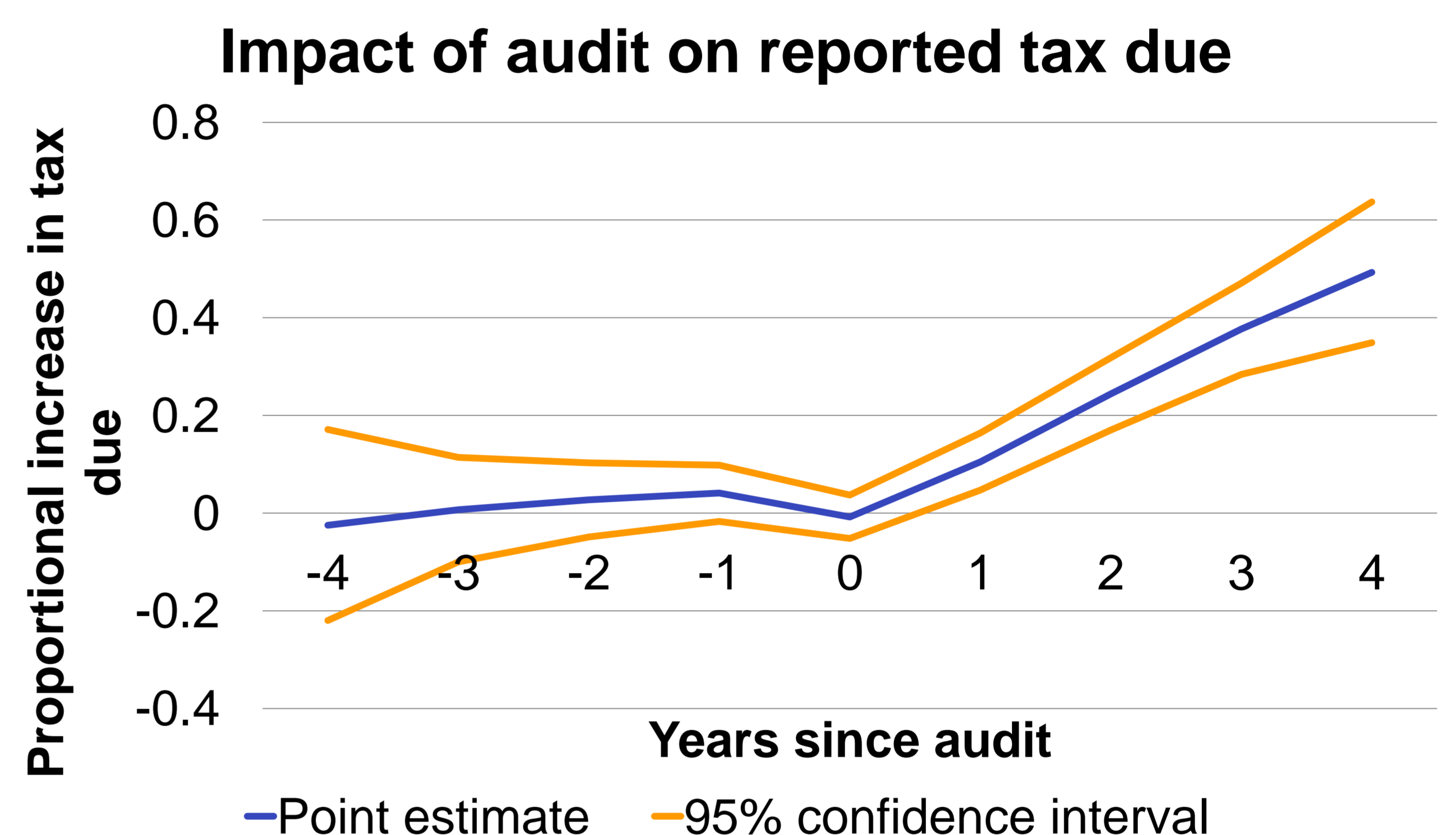
We do this by finding a group of control taxpayers that looks like audited taxpayers in all respects except that they haven't been audited. We focus on HMRC's income tax self assessment random enquiry programme and consider two alternatives:

1. Individuals who will be audited in some future period
2. Individuals who could have been selected for an audit but weren't

The results below are based on the former approach. That approach will also allow us to distinguish between the effect of audits on compliant and noncompliant taxpayers, something HMRC has expressed an interest in.

Results

The graph below shows the impact of being audited on reported tax due, considering horizons from four years before the audit to four years after it. If treatment and control groups are comparable, then we would expect to find no impact before the audit takes place. This is what we find (the confidence interval straddles zero). After the audit, we see a strong and growing impact on audited taxpayers, who report significantly more tax due, reaching around 50% by the fourth year.



Future plans

We plan the following analysis

1. Use alternative method to construct control group
2. See how results differ by type of income
3. Consider different random enquiry programmes
4. Investigate network effects

Policy relevance

This project will provide important insights into the long-run and network effects of audits, allowing HMRC to account better for their revenue implications. It will also demonstrate how to target audits in networks where no one has been audited previously, and how to conduct follow-up audits with other taxpayers in the network.

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