Who is audited? Experimental study on rule-based and human tax auditing schemes

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Yoshio Kamijo[a, b], Takehito Masuda[b, c, 1], Hiroshi Uemura[a, b]

[a] *School of Management, Kochi University of Technology, Tosayamada, Kami, Kochi 782-8502, Japan*

[b] *Research Center for Social Design Engineering, Research Institute, Kochi University of Technology, Tosayamada, Kami, Kochi 782-8502, Japan*

[c] *Japan Society for the Promotion of Science, Kojimachi Business Center Building, 5-3-1 Kojimachi, Chiyoda-ku, Tokyo 102-0083, Japan*

Abstract

In this study, we employ a game theoretic framework to formulate and analyze tax audit schemes; we test the theoretical predictions in a laboratory experiment. We compare five audit schemes including three rule-based audits: random audit rule, cut-off audit rule, and lowest income reporter audited rule. The cut-off audit rule is theoretically optimal but, to the best of our knowledge, it has not been experimentally examined. We also employ a novel experimental design for two schemes involving the human auditor conditions. The rule-based audits experimentally enhance tax compliance as predicted, and cut-off yields the highest tax revenue among the three rule-based audits in the lab. Moreover, beyond our prediction, the human auditor conditions maximized tax revenue among the five schemes in the lab. This suggests that auditors' strategic ambiguity is another route to enhance tax compliance. We also show that subjects' social norms regarding tax payment influence the choice of tax evasion, in accordance with the experimental literature.

JEL Classification: C91; D81; H26

Keywords: audit schemes; tax evasion; laboratory experiment; cut-off rule; lowest income reporter audited rule; ambiguity

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[1] Corresponding author. Postal address: Institute of Social and Economic Research, Osaka University, 6-1 Mihogaoka, Ibaraki, Osaka, 567-0047, Japan. Phone: +81-6-6879-8559; Fax: +81-6-6879-8583. E-mail addresses: yoshio.kamijo@gmail.com (Y. Kamijo), takehitomasuda@gmail.com (T. Masuda), and hiroshiuemura42@gmail.com (H. Uemura).