

The Effects of Peer Influence on Taxpayers' Compliance Decisions

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Prior studies have demonstrated an association between taxpayers' compliance decisions and the compliance pattern of their peers. While these studies have found such an association, they have not been able to address the question of how the measure of peer influence affects taxpayers' reporting decisions. For example, is there a direct effect, an indirect effect, or is the measure of peer influence merely correlated with other variables affecting taxpayers' compliance decisions? This study contributes to the existing literature not only by examining the effects of peer influence on taxpayers' compliance decisions, but also by exploring potential explanations for how peer influence may affect these compliance decisions. The results suggest three major findings. First, taxpayers' noncompliance behavior (understating the tax liability on a personal income tax return) increased as the number of their peers who are believed to have understated their tax liability increased. Second, taxpayers who had previously received self-employment income had a larger number of peers who are believed to have understated their tax liability than participants who had never received self-employment income. Third, the measure of peer influence (number of peers believed to have understated their tax liability) was significantly associated with negative attitudes toward the tax system. Implications of these findings for tax policy and future tax research are discussed.

INTRODUCTION

Over the last two decades, the tax gap (the difference between the tax actually owed by taxpayers and the tax reported and collected) in the United States has skyrocketed to the point that its current magnitude is estimated to be as high as \$195 billion per year (Hamilton 1998). In an effort to address this tax gap, the Internal Revenue Service (IRS) has implemented a number of programs designed to increase compliance, including the Compliance 2000 initiative as well as its more recent modernization efforts (Guttman 1999). One challenge facing each of these efforts is the complexity of the taxpayer's decision about compliance with the tax law. A better understanding of the factors that affect the compliance decision can help the IRS more effectively design programs to increase compliance.