

Legal Aspects of Behaviourally Informed Strategies to Enhance Tax Compliance

Koos Boer and Hans Gribnau

Abstract

Revenue authorities nowadays use different kinds of behaviourally informed strategies – functioning as ‘tax nudges’ – to raise voluntary compliance. This paper begins with setting out the background of promoting voluntary compliance by employing behaviourally informed tools. Because these tax nudges are being operated in a legal environment, various legal questions arise. It is argued that the use of behaviourally informed instruments needs to be in accordance with general legal principles, such as the principle of honouring legitimate expectations and the principle of equality. The importance of these legal principles is demonstrated by analysing concrete examples, such as the pre-filled tax return and horizontal monitoring. It is argued that those legal questions should be thought through and worked out – preferably before being implemented – within a legal framework in which (legal) principles are of a fundamental nature. This paper’s focus is on the behaviourally informed tools as designed and used by the Netherlands Tax and Customs Administration.

1. Introduction

How can the Netherlands Tax and Customs Administration (NTCA) encourage taxpayers to fulfil their tax obligations in a timely and correctly manner? Literature shows that the traditional command-and-control paradigm, creating *enforced compliance* through audits and fines, is outdated and incomplete (Gangl, Hofmann & Kirchler, 2012). The deterrence approach, based on the *power of authorities*, is not only limited in its effect (*see* Frey, 2003), it is also costly and has other severe downsides as well (Gribnau, 2015; Soler Roch, 2012; Kirchler, 2007). To ensure an acceptable level of tax compliance, literature has shown that enforced compliance – based on the coercive powers of revenue authorities to enforce that taxpayers comply with their legal obligations – has to be combined with *voluntary compliance*, *i.e.* taxpayers’ willingness to comply. Thus, both the NTCA’s power and taxpayers’ trust in the NTCA are relevant, as well as their careful use, for a responsive regulation strategy – as conceptualized in the ‘slippery slope’ framework (Kirchler, Hoelzl & Wahl, 2008; *see also* Filipczyk, 2017).

Voluntary compliance based on taxpayers’ *trust in authorities* is generated by providing a service-based approach to taxpayers. Trust is enhanced through a cooperative atmosphere of mutual understanding and cooperation (Gangl et al, 2012; Kirchler, 2007). Responsive regulation demands

an understanding at the level of the tax authorities of the taxpayer's perspective and (irrational) behaviour. Attention has increasingly been devoted to promoting tax compliance by using more behaviourally informed policies. Some of these compliance-enhancing tools can be categorized as 'nudges' (Section 2.3). Other compliance strategies – such as the pre-filled tax return and horizontal monitoring – can strictly speaking not be regarded as mere nudges. However, these behaviourally informed strategies contain elements of nudges, such as the use of defaults (*e.g.* pre-filled tax return) or emphasizing social norms (*e.g.* horizontal monitoring). Although nudging is often criticized for being an umbrella concept encompassing a wide range of policies (Baldwin, 2014; Oliver, 2015; Yeung, 2012), we at times will, for the sake of brevity, refer to these behaviourally informed strategies in the area of tax administration – including the pre-filled tax return and horizontal monitoring – as *tax nudging*.

Behavioural insights offer promising applications in different policy areas.¹ In the area of tax administration different examples of choice architecture have already been put into practice by the NTCA to enhance voluntary compliance: *e.g.* the pre-filled tax return and horizontal monitoring (*see* Boer, 2013). Increasing voluntary compliance by using 'smart' behavioural tools by the NTCA should leave more resources available for enforced compliance.

However, important legal aspects of the use of choice architecture by the NTCA are still unclear. Although nudging – and the concept of libertarian paternalism in particular – has given rise to a widespread and lively academic debate on a normative level, little attention has been devoted to the actual legal boundaries that exist when nudges are being used by administrative bodies (*see*, for instance, Alemanno & Spina, 2014). In this paper we attempt to provide a legal perspective on the use of nudges by the NTCA within the area of tax administration. We focus for the most part on specific elements of the relevant legal framework, namely the so-called general principles of proper (tax) administration. Thus, principles such as the principle of equality, the principle of honouring legitimate expectations and the 'fair play principle' are used to test the legal acceptability of the use of behavioural informed policies. Furthermore, we will argue that the guarantees of a legal framework are vital for a sustainable use of tax nudges to enhance voluntary compliance.

This paper is aimed at providing a legal perspective on tax nudging – not an empirical one. The research objective is to explore the legal boundaries that should be taken into account when behaviourally informed strategies are employed by the NTCA to improve voluntary tax compliance. Section 2 introduces the importance of behavioural insights for policy makers, in particular in the area of tax compliance. Section 3 provides examples of behaviourally informed actions by the NTCA.

¹ For examples, *see* the UK's Behavioural Insights Team reports. Available from www.behaviouralinsights.co.uk/publications/

In this section (i) the blue envelope, (ii) the pre-filled tax return and (iii) horizontal monitoring are addressed. In Section 4 the legal boundaries on the use of tax nudges are discussed. Finally, Section 5 contains the conclusions.

2. Behaviourally Informed Strategies and Tax Administration

2.1. Behavioural Insights and Compliance Approach

Nudging people to pay their taxes is one of the contemporary instruments to improve the service-based approach to taxpayers. In general, a ‘nudge’ can be described as “any aspect of choice architecture that alters people’s behaviour in a predictable way without forbidding any options or significantly changing their economic incentives” (Thaler & Sunstein, 2008, p. 6). Nudges are intended to steer without changing the economic outcomes structure, and without affecting the decision-maker’s ‘freedom’. Generally speaking, this is done by “giving information and social cues so as to help people do positive things for themselves and society” (John et al, 2013, p. 9). Note, however, that the central idea of ‘libertarian decision-making’ is not easy to define objectively. A measure perceived as a freedom-preserving nudge by one person, may be disliked as a pushy mandate by another. Different elements are relevant when it comes to the appreciation of nudges and endorsement for the use of nudges varies from country to country (see Reisch & Sunstein, 2016; Sunstein, Reisch & Rauber, 2017).²

To what extent can nudges contribute to helping taxpayers fulfil their legal obligations and what legal questions arise from the use of nudges? Some nudges can support a service approach such as providing information in time (‘weaker nudges’), while other nudges seem to be more intrusive, such as the defaults that are behind the pre-populated amounts in the pre-filled tax return (‘stronger nudges’). In the following subsections the concept of ‘tax nudging’ as a compliance-enhancing tool is discussed.

2.2. Concept of ‘Tax Nudging’

Insights from the fields of law, economics and psychology are brought together in the behavioural economic nudging approach that was introduced by Thaler and Sunstein (2008). They advocate the use of nudges by policy makers and government agencies to make people’s lives healthier, wealthier and happier. This idea is referred to as ‘libertarian paternalism’: an approach that highlights that, although choices of individuals (citizens, consumers, taxpayers) are being steered in the direction of

² They advance the proposition that countries with less enthusiasm for nudges have a reduced trust in government.

the perceived self-interest ('paternalism'), individuals eventually make their own decisions ('libertarian'). Choices are 'only' being influenced. As Thaler and Sunstein (2008) note, libertarian paternalism is a relatively soft and non-intrusive type of paternalism (*see also* Sunstein, 2014). Choices are not forbidden or significantly burdened. The final decision rests with the individual who is still 'free to choose'. Thus, nudging is a softer tool of intervention. Compared to laws and mandates, these instruments are likely to be more acceptable to modern citizens who value their individual freedoms and want to be active choosers. Nudging works best when there is a shared consensus about accepted behaviours for policy areas like tax, recycling, donating to charity, voting and local volunteering (John et al, 2013). In addition to the aforementioned characteristics, to count as a mere nudge, the "intervention must be easy and cheap to avoid" (Thaler & Sunstein, 2008). Based on this definition, a nudge contains no significant financial incentives. Furthermore, there should be an easy and cheap possibility to avoid the nudge (low-cost opt-out).

Both elements preclude that tax (dis)incentives – for instance to promote entrepreneurship or to discourage the use of tobacco and alcohol ('sin taxes'³) – or the possibility of a penalty can be considered 'tax nudges' (*see* Gribnau, 2012; Vording, 2012). Tax (dis)incentives are deliberately designed to change the economic outcomes of decisions. Thaler and Sunstein (2008) mention an example of what we would call 'budgetary nudging' (by the tax legislator) instead of 'tax nudging' (by the NTCA):

If the government taxes candy, they [Econs, JPB/HG] will buy less candy, but they are not influenced by such 'irrelevant' factors as the order in which options [products in a supermarket or restaurant, JPB/HG] are displayed.

As the previous example shows, policy aims can easily be pursued by using behaviourally informed tools in 'daily life'. Policy makers and government bodies can try to achieve public aims by simply changing the context in which a decision is made (Sunstein, 2014). It is easy to see that these alterations of context raise legal questions, because they are withdrawn from the 'public eye', come into existence without any democratic legitimization and tend to escape judicial scrutiny. Alemanno and Spina (2014) correctly point out the difficulty with nudging in a legal environment: they tend to be disguised.

³ For another example, *see* 'Jamie Oliver: David Cameron Must Be Brave with Sugar Tax', *The Guardian* 19 October 2015. Available from www.theguardian.com/society/2015/oct/19/jamie-oliver-david-cameron-has-not-written-off-sugar-tax Cf. Bogenschneider (2017) on this 'more direct form of paternalism where consumer choices are presumed to be non-rational in many cases'.

A government that wants to influence peoples' behaviour should always (be able to) explain and justify its decisions. Or, as Sunstein (2015, p. 23) puts it: "All government action, including nudges, should face a burden of justification." Tax nudges are, contrary to budgetary nudges (tax incentives), generally speaking not part of a legislative debate preceding their introduction. Nudges are typically introduced by the NTCA without parliamentary debate. Executive bodies, such as the NTCA, can thereby act without an *ex ante* justification. Although in some cases there might be an *ex post* parliamentary debate, in case the use of a nudge gives rise to public indignation, but this is only non-structural and afterwards. It can therefore be argued that there is a clear flaw in the democratic legitimization of nudges. Only in individual cases, when (the effect of) a nudge is challenged by an individual taxpayer, judges can deliver justice – as will be demonstrated in the following (*cf.* Van Aaken, 2015).

This paper's focus is on interventions by the NTCA in the tax enforcement process. Thus, this paper is about nudge as a soft instrument to enhance taxpayers' compliance with the law rather than using tax laws to change taxpayers' behaviour. This fits in well with Sunstein's distinction between means and ends paternalism. Means paternalism respects individuals' ends and attempts only to affect their choices of means – promoting their own ends, as individuals themselves understand them. Enhancing taxpayers' (voluntary) compliance with tax laws is a form of means paternalism because the end (compliance) is a given. Tax nudging is only used to affect taxpayers' choices of means in order to achieve voluntary compliance – the alternative being enforced compliance. Hard paternalism tries to influence their choices of ends. Moreover, some varieties of paternalism are 'highly aggressive' or 'hard'. Soft paternalism, however, is weaker, and because it preserves freedom of choice, Sunstein (2014, p. 19) calls it 'essentially libertarian.' He argues for a continuum rather than a categorical distinction between hard and soft paternalism – soft paternalism is improving people's welfare by influencing their choices without imposing material costs on those choices. Again, in this paper we only deal with nudges that enhance taxpayers' compliance with the law as a form of soft (means) paternalism.

2.3. Human Fallibility and Decision-Making

The concept of nudging is based on the premise that individuals' abilities to make decisions are overestimated, as Amos Tversky and Daniel Kahneman (1974) already demonstrated in the early 1970s. Unlike theoretical economists seem to believe, individuals are not infallible when choices are being made (*Homo economicus*; 'Econs'). People are 'people' ('Humans') and make mistakes (heuristic biases); they are – for instance – too optimistic when planning ahead and have insufficient experience or knowledge on complicated issues such as insurances and pension plans. Econs respond

to ‘incentives’, just like Humans, but the latter group also reacts to ‘irrelevant’ factors, such as ‘nudges’.

James (2017) argues that the main difficulty with an incentive-based approach to compliance is that it relies too much on the assumption that taxpayers are Econs, capable of precise calculations of (dis)advantages (such as the risk of audits and penalties), and may have adverse effects on Humans who are motivated by a wider range of factors. Moreover, he concludes from empirical literature that if taxpayers are Humans rather than Econs, “an unduly harsh policy of enforcing tax compliance may produce undesirable and unnecessary side effects such as taxpayer resistance” (James, 2017, p. 325).

The distinction between Humans and Econs is explained on the basis of psychological and neuroscientific grounds, caused by the different cognitive systems active in the brain (Kahneman, 2011). The first system is an automatic and intuitive system (Automatic System) and the other a reflective and rational system (Reflective System). Humans – unlike Econs – often act on intuitive responses of the Automatic System. The characteristics of both systems are juxtaposed by Thaler and Sunstein (2008; Table 1):

Table 1: Two Cognitive Systems

<i>Automatic System</i>	<i>Reflective System</i>
Uncontrolled	Controlled
Effortless	Effortful
Associative	Deductive
Fast	Slow
Unconscious	Self-aware
Skilled	Rule-following

It is not necessary to describe all of the features presented in this table to indicate that humans are not (fully) rational decision-makers. When decisions are made the Automatic System and Reflective System affect each other. As a rule of thumb, one could say that ‘everything’ can be relevant when making a choice.⁴ More specifically, the influence exerted by factors within the Automatic System plays an important role, such as ‘anchoring’ (the starting point influences the final decision),

⁴ An overview of nudges that can be used to influence behaviour are often presented by the use of acronyms, such as ‘EAST’ (www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST_FA_WEB.pdf), ‘MINDSPACE’ (<https://www.instituteforgovernment.org.uk/sites/default/files/publications/MINDSPACE.pdf>) and ‘NUDGING’ (Thaler and Sunstein, 2008, p. 102).

'availability' (how vividly present is something in mind) and 'representativeness' (thinking in stereotypes and frames). Combined with features like 'optimism' and 'overconfidence', the stronger value of losses than gains, respect for the status quo and the influence of the setting of a message ('framing'), these factors make Humans susceptible to a gentle push in the 'right' direction ('nudge').

Behavioural insights can be applied in different ways and it seems relatively easy to exploit the human fallibility. Thaler and Sunstein give clear examples of different ways in which libertarian paternalism can be applied. Placing a bowl of nuts out of reach prevents guests from eating too much before dinner (removing temptation). Default settings of mobile phones and computers are in practice always followed ('mindless choosing' or default settings). And hiding the alarm clock ('promote self-discipline') and creating self-invented jars ('mental accounting') are other examples of libertarian paternalism according to Thaler and Sunstein.⁵

Individual decisions are also strongly dependent on someone's position with respect to the peer group. Individuals want to belong to the group and do not want to 'stay behind' or 'feel alone'. Thaler and Sunstein (2008) give an example in this respect of an experiment in Minnesota regarding information provided to taxpayers:

Some were told that their taxes went to various good works, including education, police protection, and fire protection. Others were threatened with information about the risks of punishment for noncompliance. Others were given information about how they might help if they were confused or uncertain about how to fill out their tax forms. Still others were just told that more than 90 percent of Minnesotans already complied, in full, with their obligations under the tax law.

Only the latter alternative had a significant effect on the compliance rate. *Vice versa* it seems that taxpayers will be less inclined to be compliant, if other taxpayers do not follow the rules either.

Based on research it seems to be effective to promote tax compliance by emphasizing social norms.⁶

2.4. Tax Obligations and Compliance

⁵ See the 20 additional examples of nudges provided by Thaler and Sunstein (2008).

⁶ The relationship between social norms and personal ethics is complex. Cf. Wenzel (2005, p. 18): Empirical research shows that social norms causally affect taxpaying behaviour (whereas they are at least partly mediated by their internalization as personal tax ethics). Conversely, social norms also seem to be affected by taxpaying behaviour, perhaps they are construed in order to rationalize one's behavioural choices (again, this effect was mediated by personal tax ethics). It would appear that, taxpayers start bringing their own tax ethics in line with their taxpaying behaviour, and then, "they generalise and project these personal ethics to other people presumably for the sake of further rationalisation and the construction of social support."

In order to find a preliminary answer to the question of what legal boundaries should be taken into account when behaviourally informed strategies are being used by the NTCA, a more detailed definition of 'tax obligations' and 'tax compliance' is provided in this section.

In this respect, the work performed by OECD Forum on Tax Administration (FTA) can be a useful point of reference. In the Guidance Note of the FTA in 2004, with the title *Managing and Improving Tax Compliance*, the 'compliance risk management approach' was advocated as the preferential strategy for revenue authorities. Compliance risk management is aimed at controlling risks that affect the compliance with tax obligations. In this memorandum the following categories of obligations that exist for taxpayers were identified (OECD, 2004):

1. Registration in the system;
2. Timely filing or lodgement of requisite taxation information;
3. Reporting of complete and accurate information (incorporating good record keeping); and
4. Payment of taxation obligations on time.

The definition of compliance used in this memorandum refers to the extent to which taxpayers meet their tax obligations. Obviously, this broad definition covers a wide range of events that can be regarded as tax compliance. As indicated by the FTA, non-compliance in the given definition

may be due to unintentional error as well as intentional fraud (...). In addition, a taxpayer may technically meet their obligations but compliance may be in question due to interpretational differences of the law. In such circumstances, clarity of the taxation law represents a category of risk to be addressed – either by changing the law or changing the way in which it is administered.

The conclusions summed up by the FTA in the Guidance Note start with encouraging voluntary tax compliance amongst taxpayers. Departing from this point, it is worthwhile to examine the opportunities that behavioural insights offer to support taxpayers in meeting their tax obligations. In other words, can 'tax nudges' enhance compliance? An investigation into the use of nudges is consistent with the comments made in Guidance Note on the critical success factors of voluntary compliance (OECD, 2004, p. 10):

The objective of tax administration may be constant – optimising collections under the law and increasing the levels of voluntary compliance in ways that sustains community confidence – but the means to achieving it are not. Success is founded on innovation and

cooperation in understanding the market place, recognising differences and devising approaches accordingly. Such an approach recognises that almost all jurisdictions rely, at least to some extent, on self-assessment, given that a system based on reviewing every event or transaction that may have taxation implications would be too intrusive, time-consuming and costly.

Tax laws are notoriously complex. This comes at the expense of taxpayer's legal certainty.

Compliance is often costly and time-consuming, for instance time and costs involved in filing a tax return.⁷ In addition, psychological costs incur, because taxpayers suffer stress, anxiety and frustration as a result of attempts to comply with tax obligations (Evans, 2008, p. 451). These compliance costs entail a serious threat to the legitimacy of the tax system. Moreover, a lack of knowledge and understanding of the (highly complex) tax system may be a serious impediment to compliance, resulting in 'unintentional non-compliance' and '(un)intentional over-compliance'. Taxpayers may be unintentionally non-compliant or over-compliant, meaning that they may accidentally understate or overstate their tax liability. Taxpayers may even intentionally over-comply, for reasons of risk aversion or a sense of duty.⁸ Taxpayers may also want to spend as little time as possible on completing their tax return accepting that they might pay too much. McKerchar (2001, p. 267; 2007, p. 192) found that rather than spend time on reading or researching a particular instruction or aspect of their tax return, "subjects were prepared to overstate their income or under claim their deductions."

Thus, tax complexity does not only go at the expense of certainty, but also threatens equality because not all taxpayers are paying their 'due amount'. Here, instruments and measures that make it more easy to be compliant, for example providing adequate information, enhance legal certainty, equality, legitimacy and trust in the tax authorities. Of course, a single piece of information provided, for example by way of a telephone call, may help taxpayers to comply with their legal obligations. This paper, however, focuses more on the various systems designed to improve compliance rather than individual doings.

In the next paragraph, the position of the revenue authorities – and not the tax legislator – is put forward when compliance-enhancing tools are addressed. From this perspective it is examined how insights, derived from behavioural science as described in the previous section, can be used to enhance compliance in the massive and legal environment of tax administration. In Section 3

⁷ The Dutch regulation policy seeks to diminish the bureaucracy, the pressure of rules, administrative burdens and the lack of autonomy. Cf. Bokhorst (2015).

⁸ McCaffery (2014, p. 604), argues that there "is almost certainly widespread cognitive error when it comes to calculating the costs and risk of noncompliance."

examples of the use of tax nudges by the NTCA in the tax implementation practice in the Netherlands are discussed.

2.5. 'Tax Nudges' as an Instrument to Enhance Compliance

When it comes to identifying and understanding compliance risks, both an economic and behavioural approach must be adopted (OECD, 2004). Although empirical research in this area is still developing, there are several factors that can be perceived as relevant for non-compliant behaviour (see, for instance, Webley, 2004). Relevant factors are: (i) equity (the perceived fairness of the tax system), (ii) opportunity for non-compliance, (iii) individual differences, (iv) social norms (understanding of the compliance behaviour of other taxpayers) and (v) dissatisfaction with revenue authorities.

Notwithstanding other factors that can be relevant to taxpayers' compliance, the list demonstrates the importance of behavioural aspects for tax compliance.

Compliance-enhancing nudges may be used to diminish under-compliance and create an equal distribution of the tax burden (principle of equality). This might be called 'pure public nudging.' (Alemanno & Sibony, 2015, p. 18). As under-compliance would mean that other taxpayers are faced with more expensive public goods and services, or even would be deprived thereof,⁹ steering taxpayers' behaviour in the public interest would always be a perfectly legitimate aim. Tax nudging aimed at reducing intentional over-compliance helps taxpayers who unintentionally pay too much to restore the individual taxpayers' (negative) liberty – for paying the right amount of taxes means less interference with his liberty.¹⁰ Moreover, promoting tax compliance is also a matter of enhancing interaction between taxpayers and tax authorities without resort to deterrence. Here, nudges may provide 'communicative solutions' supporting compliance and lead to trust in authorities (Van Aaken, 2015).

A better understanding of the drivers of compliance behaviour is useful to be better equipped to design and implement adequate responses to compliance risks (OECD, 2012). This position was already taken in the FTA's note *Understanding and Influencing Taxpayers' Compliance Behaviour*, published in 2010, focusing on six main headings: (1) deterrence, (2) norms, (3) opportunity, (4) fairness and trust, (5) economic factors and (6) interactions between these factors. The research described in the FTA's note supports the idea that a better understanding of how to influence taxpayers' behaviour is vital to develop compliance strategies. The FTA explicitly refers to

⁹ Van Aaken (2015, p. 88) even argues that there is no problem with nudging "if the only intent of the measure is to reduce third party externalities, protect the public or promote public welfare, paternalism is not involved."

¹⁰ The concept of negative liberty was introduced by Isaiah Berlin (1969). He used the concept to describe liberty (freedom) from some form of interference or coercion (sanctions, barriers or restrictions on individual choices). Negative liberty is distinguished from positive liberty, meaning self-mastery or self-expression (see also Neumann, 2015).

Thaler and Sunstein when it comes to human fallibility in decision-making (OECD, 2010). However, the FTA states:

this does not mean that it is impossible to understand, explain or predict behaviour. But the heuristics and biases that affect the taxpayers' decisions and behaviour should be taken into account.

The susceptibility to nudges can be used when developing compliance-enhancing strategies. In the information note *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* the FTA elaborates on this (OECD, 2012, p. 9):

Applying these insights and terms to the context of compliance risk management, revenue bodies can look for ways to make changes to the choice architecture in the compliance environment that will serve as nudges increasing the likelihood of compliance. Through such deliberate changes to the choice architecture revenue bodies can contribute to the creation of a more pro-compliance environment that will offer benefits to the revenue body as well as the taxpayers and other stakeholders.

Given the widespread attention policy makers around the world have already devoted to nudges (Ly & Soman, 2013),¹¹ it seems worthwhile to explore how changes to the choice architecture are incorporated in current tax administration policy in the Netherlands. Furthermore, it will be researched what legal boundaries can be determined for the use of tax nudges. These boundaries are based on a legal framework derived from general legal principles, and provide legal guidance for the use of tax nudges to enhance compliance.

3. 'Tax Nudges' in The Netherlands¹²

3.1. Introduction

Behavioural insights seem to offer various opportunities in the area of public policy. The UK Behavioural Insight Team¹³ – also referred to as the Nudge Unit – has already published seven

¹¹ A database of behavioural interventions can be found at: <https://www.stir.ac.uk/media/stirling/services/faculties/social-sciences/research/documents/Nudge-Database-1.2.pdf>.

¹² This section is based on Boer (2013).

¹³ See www.behaviouralinsights.co.uk. In the US behavioural insights are translated to policy agencies by the Social and Behavioral Sciences Team (SBST); <https://sbst.gov>.

reports, dealing with six different policy areas, such as energy use, charitable giving and donor registration.¹⁴ These reports highlight several possibilities in the area of tax administration as well.

Like other revenue bodies,¹⁵ The NTCA is aware of the possibility of influencing the behaviour of taxpayers to improve compliance. Hereafter, three examples of choice architecture applied by the NTCA are presented in which compliance is enhanced without changing the financial structure and providing a 'low-cost opt-out'. Subsequently (i) the blue envelope, (ii) the pre-filled tax return and (iii) horizontal monitoring are addressed. Although horizontal monitoring might not fit the precise definition of a 'nudge', because of the high costs involved,¹⁶ it is presented as a tax nudge in this paper because it is a behaviourally informed tool, emphasizing social norms and mutual trust.

3.2. Current Practice

3.2.1. Blue Envelope

The best known example of a 'subtle nudge' is perhaps the use of the blue envelope by the NTCA. Anyone in the Netherlands who receives a blue envelope, immediately knows that it is a letter from the NTCA. The motives for the choice of the colour blue remain unclear. However, the reason for the introduction of a uniform colour (already in the fiscal year 1914/1915!) is the idea of increasing the visibility of letters from the NTCA ('signal function'). This method has been extended to provide each task (performed by different units) of the NTCA with a distinct colour: taxes (blue), personal allowances (red) and customs (green). These colours are also referred to in other expressions by the NTCA, such as brochures and TV commercials.

Although no published¹⁷ data is available regarding the effect of the blue envelope, the use of this instrument undeniably has a twofold character. On the one hand, it functions as a stimulus. Taxpayers are reminded that they (still) have to fill in their return when they see the blue envelope on the table. This creates awareness and a sense of urgency. It can perhaps be concluded that people's attention is being drawn by the blue envelope, because companies in the Netherlands have repeatedly put advertising messages in a blue envelope to generate attention.¹⁸ On the other hand,

¹⁴ See www.behaviouralinsights.co.uk.

¹⁵ See for various examples of 'tax nudges' in several other OECD Member States: OECD (2017), Chapter 12.

¹⁶ On the other hand, it can be argued that most taxpayers suitable for horizontal monitoring already have some kind of tax control framework in place and therefore the relevant costs are significantly lower. See Veldhuizen (2015); Huiskers-Stoop and Gribnau (2018).

¹⁷ We are grateful for the insights provided to us by researchers of the NTCA as background information for this paragraph.

¹⁸ The Dutch Advertising Code Committee ruled in a number of cases that the use of the blue envelope for advertising purposes is misleading. The use of the colour blue by the NTCA is nowadays protected by a patent (since 1993). Although little is known on this topic, it seems plausible that this 'subtle nudge' will be continued within the digital communication ambitions of the NTCA.

the blue envelope can be scary, restraining taxpayers from opening the envelope. This probably regards taxpayers that dread doing all the paperwork or taxpayers that expect a high tax assessment.

Although the overall balance of the opposite effects remains unclear, it is fair to conclude that of the blue envelope sends out a strong signal.

3.2.2. Pre-filled Tax Return (PTR)

The NTCA started to pre-fill certain items in the income tax return of individual taxpayers in 2008.¹⁹ This was done based on taxpayer data available to the NTCA at the time, which included personal information of taxpayers (and their partners) as well as information relating to taxpayers' income and assets. Because more information on taxpayers has come available to the NTCA since 2008, the PTR has seen a significant development. The PTR can be viewed as a nudge. Taxpayers are helped to fill in their tax return ('make it easy'), reducing the red tape (partially). The PTR also increases compliance because taxpayers are prevented from making unintentional errors. Furthermore, it can be said that – although taxpayers can change the pre-filled information – the displayed data functions as a 'default'.²⁰

For the fiscal year 2012 the extensive list of pre-filled data (wages, pension payments, etc.) was expanded with the following information:

- Bank account balances and savings
- Portfolio value
- Loans and other debts
- Foreign (Belgian and German) pension plans
- Disability Insurance premiums
- Foreign savings
- The name of the person from whom you receive a personal budget

Despite the recent years' development, the ambitious pursuit of a completely pre-filled tax return is hampered by a number of factors. First, there are certain categories of income that cannot be known to the NTCA without self-reporting, such as business income and income from other activities. For this reason, the PTR will always be incomplete for a large group of taxpayers, such as entrepreneurs. Second, the completeness of the PTR is significantly burdened by the use of tax law instrumentalism.

¹⁹ The pre-filled tax return is similar to the Automatic Tax Return as discussed by Thaler and Sunstein (2008, p. 228-229).

²⁰ In connection with the PTR other elements of behaviourally informed strategy are being considered as well. For instance, the question whether it is relevant – from a compliance perspective – that taxpayers sign before or after they have completed the tax return. Fonseca and Grimshaw (2017) conclude that signing at the beginning is an effective nudge.

The amount for special deductions, for example charitable donations, cannot be included in a PTR. From a PTR perspective, tax facilities and special deductions obviously create restrictions for an all-inclusive PTR. This conflict between the desire for a fully automated tax return – and eventually tax assessment – and tax law instrumentalism seems to limit the future possibilities of tax law as a policy instrument. Third, there is still a significant group of taxpayers that cannot file a digital tax return or is unwilling to do so. The old-fashioned way to communicate with the NTCA must remain available for these taxpayers.²¹

From a legal perspective several questions can be raised by the PTR. How should cases be dealt with in which a taxable income component is not included in the PTR by the NCTA? Does this provoke tax fraud? Does the pre-filled information in a PTR function as a *de facto* ‘default’? Are taxpayers equipped to take a critical stance towards the NTCA when it comes to pre-filled misinformation or errors? For example, when a taxpayer has purchased a dwelling and he is unsure whether expenses are deductible – for example valuation costs to obtain a mortgage loan – will the choice of the taxpayer be affected by the fact that this expense is or is not included in the PTR? Given these questions, pre-filled data cannot simply be regarded as ‘comfort information’ to taxpayers, since they have foreseeable legal consequences as well.

Finally, it can be observed that the PTR changes the characteristics of the Personal Income Tax (PIT). The nature of the PIT may gradually shift from an ‘administrative assessment tax’ to a ‘self-assessment tax’ (see Section 4.2).²² This ‘informal’ shift towards a self-assessment tax – an assessment that can easily be reassessed by the NTCA – influences the legal safeguards that a ‘final’ tax assessment provides to taxpayers. The ‘administrative assessment’ system inherently provides legal protection, because a (final) tax assessment can – in principle – not be reassessed. Besides cases of ‘fraud’ and evident mistakes, a tax assessment that has been imposed by the NTCA cannot be altered by the NTCA, unless the tax inspector has gained ‘new information’ on the taxpayer that he could not have been aware of when the tax assessment was finalized (‘new fact doctrine’). The system in which the tax inspector imposes a tax assessment explicitly entails the legitimate expectation that the tax assessment is ‘final’. Therefore, the tax inspector can only issue an additional – corrective – assessment if certain conditions are met.

²¹ The Dutch Coalition Agreement 2017-2021 states: ‘people who are not able to communicate electronically must continue to be able to communicate in other ways. Communication with government by post will therefore remain available as an option.’ Coalition Agreement 2017-2021, ‘Confidence in the Future’, 10 October 2017, p. 10-11; www.kabinetsformatie2017.nl/documenten/verslagen/2017/10/10/coalition-agreement-confidence-in-the-future.

²² The OECD (2015) observes a global shift from ‘administrative assessment’ to ‘self-assessment’ systems of taxation.

In a self-assessment system this is different because the tax inspector was not involved in the process of determining the amount of tax. The PTR looks like a self-assessment tax; the taxpayer verifies the pre-filled information and – by doing so – determines his/her own tax assessment without involvement of a tax inspector. Given the absence of a (check by the) tax inspector in determining the amount of tax due, no legitimate expectations can be raised in the assessment process. As a result taxpayers cannot derive legal protection from a (final) tax assessment because of the actual involvement of a tax inspector.

A self-assessment tax would thus imply a dramatic change when it comes to legal protection. As professor Stevens – the chairman of the in 2011 installed Stevens Committee (see Section 3.2.3) – rightly noted in 2009 (Stevens, 2009):

I'm not yet ready to leave the new fact doctrine and to switch to a self-assessment system. Without legal safeguards, risks in the PTR system can easily be shifted to the taxpayers and legal protection will be at risk. The legislature has to move towards a fundamental revision.

Recent developments in the Netherlands indicate that the tax legislator is still struggling with this 'fundamental revision'. In 2013 the government proposed legislation that should make it easier to revise a final tax assessment in the future ("Simplification of formal relationships with the Dutch Tax Authorities").²³ Under the proposed assessment system less legal protection could be derived from a final tax assessment during the first three years after the tax assessment was issued if the taxpayer 'knew, or should have known' that information provided in the tax return was incorrect. Had this proposal been adopted, it would have been a major step towards a self-assessment process in which there would have been less legal protection for taxpayers. As a consequence it could also have paved the road for a PTR-system in which the risks of failure – *e.g.* the incorrect statement of pre-filled data – could have easily be shifted towards taxpayers.

3.2.3. Horizontal Monitoring

Since 2005 the NTCA started experimenting with another compliance strategy, namely 'horizontal monitoring': the Dutch cooperative compliance approach. This cooperation between taxpayers and NTCA is formalized in voluntarily concluded (brief) working arrangements ('covenants'). This strategy departs from the idea that the relationship between the NTCA and taxpayers has changed. In addition, the own standards of companies have changed due to the development of corporate governance. The traditional enforcement strategy – 'vertical supervision' – is time-consuming, costly

²³ *Parliamentary Documents II* 2012/12, 33 714. This proposal has been withdrawn on 1 November 2017.

and hardly feasible given the number of taxpayers and the extent and complexity of tax regulations for companies. In the traditional approach tax authorities and taxpayers can easily be placed in opposing positions, which can have an adverse effect on compliance. The horizontal monitoring approach was evaluated at the request of the Minister of Finance by the Commission Horizontal Monitoring (after its chairman: 'Stevens Committee'), this was completed in June 2012 (Stevens Committee, 2012).

The interests of corporate taxpayers (multinationals) lie first and foremost in reducing uncertainty. This means less chance for far-reaching audits, which can lead to severe administrative burdens, nuisance and unforeseen corrections to the tax position. Auditing is an important enforcement instrument for the NTCA. An audit can be carried out in the tax administration's offices on the basis of the taxpayers' information (documentary audit). Another auditing instrument is the field audit, which takes place on the firm's premises. The field audit tends to be time-consuming and costly. Besides, there is the inquisitorial nature of auditing: the taxpayer is under the obligation to provide data and information and to make books, documents and other data carriers available for audit. Furthermore, auditing to examine the accuracy of the information declared by taxpayers in their tax returns is of a retrospective nature. It often takes place years after the taxpayer has filed a tax return. Corporations, on the basis of their declared tax positions, have established their annual reports which have been made public. The verification process, however, may lead to adjustments. The tax inspector may use his legal powers to revise and reassess the tax debt declared by the taxpayer. Consequently, tax audits may result in additional payments to be made and retrospective changes in the corporation's annual report. The mere possibility of retrospective changes results in uncertainty which, understandably, is not very appealing to corporations (Gribnau, 2015).

Horizontal monitoring assumes a different working relationship between tax authorities and taxpayers. Thinking in terms of 'us vs. them' makes place for mutual trust, and owning responsibilities on the part of taxpayers is emphasized. Trust – which obviously has to be earned – is primarily based on covenants, containing the obligation to proactively share information with the NTCA. It also holds requirements for the (organization of the) financial administration of the company ('Tax Control Framework'). In return, taxpayers participating in horizontal monitoring can consult the tax inspector in case of legal uncertainties and may expect a prompt response. Furthermore, the tax inspector will in principle not deviate from the tax returns that are filed under a covenant agreement. This approach promotes voluntary compliance and allows for a more efficient enforcement method. Moreover, the NTCA can still rely on the deterrence approach in cases that demand a vertical approach. Vertical enforcement and horizontal monitoring mutually reinforce each other.

Horizontal monitoring is an informal and service-based approach that puts underlying trust-based relationships between government and citizens on a more equal footing. Communication of relevant information (relevant facts, the companies' interpretation of the law, and intended tax structures) is important to prevent misunderstandings and a 'trench warfare' of parties who perceive one another as an enemy (Gribnau, 2015). This approach is in line with the more general idea that communication-based and consensual-based techniques are important tools to secure voluntary compliance. In this way an informal 'proceduralization' exists by way of a semi-permanent dialogue with 'a critical role to deliberative, participatory procedures.' (Morgan & Yeung, 2007). Vertical supervision is reduced and in return the company provides transparency. Taxpayers are required not only to report all actions that involve tax risks but also to disclose their views about the legal consequences of such actions – including, therefore, the positions taken by them.²⁴ Hence, they are required to go beyond compliance with their statutory reporting obligations. Tax inspectors for their part share their specific monitoring strategy for the company concerned and will take a position on company-planned actions and their tax consequences.²⁵ In this way it is transparent about its response to taxpayers' actions.

As will be discussed hereafter, horizontal monitoring includes essential features of a 'nudge'. Although horizontal monitoring is based on a covenant, it influences taxpayers' behaviour without recourse to mandatory provisions and without the use of financial incentives. Key elements of horizontal monitoring are 'transparency', 'mutual trust' and 'cooperation'. This approach follows from the insight that a different enforcement approach leads to a change in the taxpayers' attitudes. The Stevens Committee explicitly mentions these social psychological aspects as part of the conceptual background of horizontal monitoring.

Horizontal monitoring is aimed at influencing behaviour in the 'right direction', in this case by emphasizing social norms. These include the importance of compliance and the (social) standards of good conduct. As the Stevens Committee (2012) reports, emphasizing social norms has a beneficial influence on the mutual understanding of tax administration and taxpayers.

Furthermore, taxpayers may terminate the horizontal monitoring relationship (opt-out). However, it is questionable whether this is a low-cost opt-out, as intended by Thaler and Sunstein. First, setting up a Tax Control Framework requires a significant investment from taxpayers. Opting-out of a covenant results in a loss of these efforts. Second, terminating the horizontal monitoring relationship might lead to the fear of unfair treatment by the NTCA (increase of distrust).

²⁴ Cf. OECD (2013, p. 20-21): Mandatory disclosure rules are impartial but, like most rules, can be circumvented. Voluntary disclosure rules can complement mandatory disclosure regimes but raise different issues. They clearly require the taxpayer to agree to go beyond compliance with their statutory reporting obligations.

²⁵ See the internal guidelines on horizontal monitoring issued by NTCA to guarantee uniform treatment with regard to cooperative compliance; enhancing equal treatment and legal certainty.

Adding up the previous arguments, one could say that ending the horizontal monitoring relationship is not ‘free of charge’. In Section 4.3, a number of legal objections that are raised against horizontal monitoring will be debated.

For instance, at various moments (i) on concluding the covenant, (ii) during the execution of the covenant and (iii) at its termination, it is questioned whether the distinction between participants and nonparticipants of horizontal monitoring is in accordance with the principle of equality. At these points, the Stevens Committee (2012) formulates recommendations to resolve some of the issues raised against horizontal monitoring, but it detects no major legal flaws. Instead, the Committee argues that the concept of horizontal monitoring is based on mutual trust and issues should not be resolved in a legal context.

3.3. Categorizing Tax Nudges

As discussed, the NTCA uses different kinds of behaviourally informed strategies to enhance taxpayers’ compliance. Some of them, functioning as nudges – for instance ‘stronger’ nudges that appeal to the Automatic System, like ‘defaults’ in a PTR – are supposedly more intrusive from a legal perspective than ‘softer’ nudges that appeal to Reflective System. To provide some guidance in discussions on the legal permissibility of nudges used by the NTCA a categorization that leads to the identification of a ‘grey area’ from a legal point of view can be useful. This table illustrates that behaviourally informed strategies can, from a ‘legal infringement’ point of view, be categorized by the likelihood that a conflict with legal boundaries can arise. We come to the following preliminary overview (Table 2):²⁶

Table 2: Legal Concerns raised by Behaviourally Informed Strategies

Behaviourally informed strategy by the NTCA	Legal Concerns		
	None	Potentially	Obviously
Nudges that appeal to the Reflective System (e.g. blue envelope, general information, salience)	X		
Nudges that appeal to the Automatic System (e.g. frames, defaults)		X	
Pre-filled tax return		X	
Horizontal monitoring		X	

This table offers an overview of the distinction between ‘stronger’ and ‘weaker’ types of nudges as

²⁶ Whether an actual legal infringement exists will depend on the context and circumstances of a specific case.

well as other behaviourally informed strategies deployed by the NTCA from a legal infringement point of view. In Section 4, we will elaborate further on these legal remarks.

As to ‘tax nudges’ that raise no legal concerns, effectiveness from a behavioural science perspective, seems to be the decisive criterion. Further psychological research is necessary to determine the effectiveness of these strategies. Tax nudges that obviously raise prohibitive legal concerns, are – regardless of their effectiveness – not permissible, unless the law is changed to allow for these instruments. The most interesting field involves ‘tax nudges’ that may (potentially) prove to raise some (non-prohibitive) legal concerns, while being effective in raising taxpayers’ compliance. In this respect, legal concerns are not decisive, while other criteria that reflect the public interest can induce the use of these ‘tax nudges’.

4. Legal Remarks on the Use of Tax Nudges in the Netherlands

4.1. Blue Envelop

It is hard to see any legal objections to this kind of soft nudge. It is quite a harmless way of making taxpayers aware of their statutory obligations and creating some sense of urgency with regard.

4.2. Pre-filled Tax Return

The PTR is part of an IT-system developed for accessing and managing information to collect PIT. Computerized data matches information from different sources, *e.g.*, corporations, banks, insurance companies, employers, creating a sophisticated risk-based audit system (Stewart, 2013). The NTCA has great interest in working with this ‘paperless’ system, which opens a wide variety of possibilities to make tax compliance easier. At the same time, the PTR gives rise to several legal questions.

Can the taxpayer rely on the information provided in the PTR? Taxpayers are asked to check the pre-populated information, but they may be inclined to rely on the PTR as a default. In the Netherlands, the NTCA is seen as a capable organization who (obviously) gets information from all kinds of ‘third parties’ (banks, insurance companies, employers, etc.). What happens if the PTR contains incorrect data that is favourable to the taxpayer? May the taxpayer rely on this information arguing that legitimate expectations have been raised? This is an important issue because the principle of honouring legitimate expectations is an often invoked strong legal principle in the Netherlands.

The NTCA has to comply with principles of proper administrative behaviour.²⁷ Most of these principles are developed in case law and some of them have been codified in the General Taxes Act

²⁷ Sometimes called ‘principles of good administration’ or ‘principles of proper government behaviour’.

(hereinafter: GTA). The most important and well-developed principles of administrative behaviour in tax law are (i) the principle of honouring legitimate expectations and (ii) the principle of equality. Other principles include the principle of fair play, of giving the grounds for the decision, proportionality, and the prohibition of the misappropriation of power.

To illustrate the importance of the principles, we will have a closer look at the principle of honouring legitimate expectations. Nowadays, most citizens do not have much knowledge of tax legislation in force and have to depend on communications by the NTCA. The tax administration, for example, may provide general information to a taxpayer, or taxpayers in general, by way of policy rules, for example on its website, but may also respond to a taxpayer's question with regard to the (application of the) tax law by promising to apply the tax law in a certain way. The principle of honouring legitimate expectations may – in exceptional circumstances – even justify a deviation from the strict application of the law (the principle of legality, therefore).

When will – or must – legitimate expectations be honoured? Suppose, that the NTCA explicitly stated to apply the tax law in a particular way. The Dutch Supreme Court has decided that the expectations raised by such a statement should be honoured (deviating from the legislation) where: (a) the taxpayer has the impression that the tax inspector is taking a position concerning the application of the tax law; (b) the taxpayer has informed the tax inspector of all relevant facts and circumstances of the case; (c) the taxpayer may reasonably think that the promise is in accordance with (the spirit of) the law, and (d) the tax inspector is competent to deal with the taxpayer.²⁸ These criteria provide for a balanced approach. For example, if the taxpayer is in bad faith, criterion (c) is not met, and the principle of legality takes precedence (Happé, 1996; Gribnau, 2014).

So what happens if the PTR contains incorrect information that is favourable to the taxpayer? Can the taxpayer rely on this information, which means that he pays less than other taxpayers in a like situation (principle of equality)? Or should his expectations not be honoured?

The PTR is used in income tax returns. Income tax is levied by way of direct assessment (also administrative assessment). This is an assessment system (see Section 3.2.2) that, in the wording of the OECD, operates “on the principle that all tax returns should be subject to a degree of technical scrutiny before a formal assessment is sent to the taxpayer.” In practice, however, many countries use automated screening techniques that – based on a risk analyses – select returns for (further) scrutiny by tax inspectors. After this manual examination a formal tax assessment is issued. This level of scrutiny carried out by technical officers, the OECD observes,

²⁸ HR 26 September 1979, no. 19250, BNB 1979/311.

ranges in practice from a very cursory examination of some tax returns to a more in-depth examination where further inquiries may be made with taxpayers (sometimes by correspondence) before a formal assessment is issued.²⁹

The point of departure here is that the tax inspector bears the responsibility for the correctness of the tax assessment, while the taxpayer bears the responsibility for the correctness of his income tax return. The tax inspector's task is to check the tax return and subsequently formalize the amount of tax due. Can the tax inspector correct a tax return that is incorrect because of an error in the calculation program of the PTR? In a case before the Court of Appeal in Leeuwarden, a taxpayer had used an automated income tax return program on a floppy disk. This program calculated the relevant threshold for the deduction of day-care expenses. Based on this calculation the taxpayer expected a refund. The tax inspector argued that the outcome was inconsistent with the law and refused the tax deduction. The court honoured the legitimate expectations of the taxpayer based on the reasoning that the layout and calculation order of the filing program implied a statement by the NTCA as to the way they would apply the law.³⁰ Since there was no 'disclaimer', the taxpayer had a legitimate expectation as to the outcome. In another case – in which the tax return program on the floppy disk provided for a provisional calculation of the income tax due – the Dutch Supreme Court ruled that “apparently as a service to the taxpayer the calculation of the income tax payable is given on the condition that no rights can be derived from the calculation” and therefore there were no legitimate expectations.³¹ This disclaimer prevented that legitimate expectations had originated for the taxpayer.

From a legal point of view, the PTR has to be regarded as 'mere service' to the taxpayer. The pre-filled data provided by the NTCA may – from that perspective – be incorrect or incomplete. The taxpayer is asked to verify this information and its legal qualification. In a recent case, the tax inspector checked a tax return in which facts were incorrectly qualified by the PTR program (the taxpayer himself did not correct this). The tax inspector immediately corrected this erroneous qualification and issued a (correct) tax assessment. The Court of Appeal decided that the taxpayer could not rely on the incorrect qualification of the income in the PTR and therefore had to accept a higher tax assessment than expected. The Supreme Court upheld this decision.³²

²⁹ The second major system is self-assessment. Cf. OECD (2006, p.10): “Returns are typically accepted as filed in the first instance (with the exception of returns containing mathematical errors or clearly erroneous deductions) and, for income tax, a formal assessment/notice confirming/advising the tax liability is sent to the taxpayer before any inquiry.” The tax administration selects a sample of returns “for post-assessment audit, generally applying computer-based risk selection techniques and/or manual screening processes”.

³⁰ Court of Appeal Leeuwarden 16 August 2002, no. 02/00301, NTFR 2002/1382.

³¹ Supreme Court 7 December 2001, no. 36 517, BNB 2002/45.

³² Supreme Court, 26 January 2018, no. 17/04130, ECLI: ECLI:NL:HR:2018:93, *V-N Vandaag* 2018/215.

But what if the tax inspector does not correct the taxpayer's incorrect tax return immediately because he does not notice the mistake or even does not check the tax return at all? What if the tax inspector finds out about the mistake *after* he has issued an incorrect assessment? Is he then allowed to correct this incorrect assessment?

Article 16 of the GTA is written for these situations (Gribnau, 2015). In principle, the tax inspector can issue an additional corrective assessment after the (final³³) tax assessment has been issued if certain conditions are fulfilled. Thus, the point of departure is that the principle of equality prevails over the principle of legal certainty if certain requirements are met. The principle of equality, requiring taxpayers in similar situations pay the same amount of tax, has to be weighed against the principle of legal certainty, indicating the protection of the taxpayer's certainty provided by the tax assessment issued with regard to the amount of tax he has to pay. The general idea behind these conditions is that the tax inspector has the responsibility to check the tax return reasonably carefully *before* imposing a tax assessment. However, an additional tax assessment can be imposed within five years³⁴ if a so-called 'new fact' comes to light: a fact unknown to the tax inspector at the time of imposing the tax assessment. In case of a new fact, new information has become available to the tax inspector *after* he imposed the tax assessment. This is, for example, the case when a tax audit results in new information. The new fact threshold is meant to preclude that the tax inspector can (repeatedly) impose an additional tax assessment in case he has changed his opinion with regard to the application (and/or understanding) of the law and/or the appreciation of the relevant facts. It precludes the tax inspector from repeatedly re-examining the (known) facts of a certain case. As a consequence, mistakes made by the tax inspector cannot be adjusted with regard to processing relevant (and available) information, nor can the negligence to follow up an evident incorrect/inconsistent factual statements be repaired.

Hence, no additional tax assessment can be imposed when the tax inspector discovers a omission made by himself or other NTCA-officials; the taxpayer may rely on the final assessment. However, there are exemptions to the 'new fact'-condition. For example, when the taxpayer has deliberately filed an incorrect tax return ('in bad faith'). Another exemption exists when a 'mistake' has been made by the tax inspector that was and should have been absolutely clear to the taxpayer: *e.g.* a slip of the pen, a typo or a miscalculation. An additional tax assessment can also be imposed – based on a special provision in the GTA – if the taxpayer could have 'reasonably known'³⁵ that the

³³ With regard to personal and corporate income tax, a preliminary tax assessment, often based on the taxable amount of the previous year(s), usually precedes the final assessment.

³⁴ For foreign source income there is an extended 12-year period.

³⁵ Which is deemed to be the case if the tax paid is 30% (or more) too low.

final tax assessment was incorrect because of mistakes caused by the tax administration's ICT-processes and the like.³⁶

First of all, it is our opinion that taxpayers – in general – cannot rely on the pre-filled numbers and figures as such. Not only does the NTCA clearly communicate that the taxpayer has to check the pre-populated information, the NTCA also emphasizes that taxpayers remain responsible for the correctness of the information supplied. Although we believe that this prevents arousal of legitimate expectations, it is obvious that the numbers will function as a 'default'. This default makes it 'easy' to comply with, but makes it easy to make errors as well.

So when the correct information leads to an incorrect tax return – and ditto tax assessment because the tax inspector does not recognize the incorrect statement – a more balanced outcome has to be achieved. As mentioned before, the PTR could lead to an incorrect calculation because of errors in the tax return program itself even if the correct pre-populated figures were used. Can the tax inspector, discovering this error after the final assessment has already been issued, impose an additional assessment?

Although a calculation error caused by the NTCA's ICT-processes may qualify as a 'mistake' under the GTA, this can only be reassessed in the event that the taxpayer could have 'reasonably known' (including the 30% difference-rule) that the final tax assessment was incorrect.³⁷ Apart from cases in which the amount due, according to the incorrect assessment, is (at least 30%) too low, we would argue that this mistake is not knowable to the taxpayer. Therefore, an additional assessment could not be issued successfully. The Supreme Court has ruled that if the NTCA has chosen a certain working method – including the usage of ICT – the risks thereof are borne by the NTCA.³⁸ Furthermore, the PTR contains no explicit disclaimer in this respect, so we do not expect the Supreme Court would allow a correction in this respect.

Another possibility mentioned above, is that an incorrect tax assessment is the result of an incorrect qualification of a correct amount in the PTR program. In our opinion it is certainly not obvious that the taxpayer can be confronted with an additional tax assessment if this incorrect qualification is discovered *after* the final assessment has been imposed. It would – apart from cases where the 30%-rule applies – depend on the knowledge and experience of the individual taxpayer to conclude whether or not the mistake was foreseeable. Due to the increasing complexity of the current tax laws in the Netherlands and the perceived correctness of the qualification provided for by

³⁶ In these last cases the standard five-year period is reduced to two years after the final tax assessment has been imposed.

³⁷ Supreme Court 27 June 2014, no. 14/00350, BNB 2014/203.

³⁸ Supreme Court 14 March 2006, no. 40.958, BNB 2006/315.

the NTCA – which is understandable from the perspective of an average taxpayer – we would not easily accept that this risk should be shifted towards the taxpayer.

4.3. Horizontal Monitoring

Horizontal monitoring is based on trust, transparency and mutual understanding and is meant to support voluntary compliance (Van der Hel-van Dijk & Pheijffer, 2012). Horizontal monitoring is – ultimately – embedded in a vertical monitoring framework. If a taxpayer does not behave according to (the spirit of) the covenant, the NTCA can exercise in-depth audits, impose fines or start investigations. How does horizontal monitoring relate to the legal framework, *i.e.* the statutory competences of NTCA, the statutory rights and obligations of the taxpayer and the principles of proper administration? The State Secretary of Finance states:³⁹

Upon concluding a covenant, arrangements are made about settling the past, thus increasing legal certainty. Another aim is to have tax inspectors take a stance on corporations' future actions and their tax consequences. This is also possible because as yet unsettled 'problems of past years' no longer constitute an impediment to taking a stance. This is based on the premise that the law is applied and that no more or less favourable stances are taken. Another premise is that corporations report actions that have a bearing on tax openly and in well in time.

In the context of horizontal monitoring, the law is always applied within the framework of the tax code, case law and policy (rules). In terms of outcome, they are no different compared to other types of enforcement, more specifically vertical monitoring. Covenants must not be seen as ways to pay less taxes than due according to the law. Only the process, the way the outcome is achieved, is different. Therefore, the principle of equality is (theoretically, at least) not at stake.⁴⁰

Horizontal monitoring as a modern type of behaviourally informed strategy is important for the NTCA – it prevents the NTCA and taxpayers from ending up in costly and time-consuming discussions. It is therefore encouraged by the NTCA that covenants are being concluded with large enterprises. Obviously, some taxpayers are hesitant about engaging in horizontal monitoring. So concerns are openly expressed that the NTCA might favour taxpayers to 'win them over' when concluding a covenant. This could be done by not delving too deeply in the past. Consciously not

³⁹ *Parliamentary Documents* ['Kamerstukken'] II, 2005/06, 30 300 IXB, no. 40, p. 13.

⁴⁰ *Cf. Parliamentary Documents II* 2004/05, 29 800, No. 2 and Stevens Committee (2012, p. 96). *See also* OECD (2013, p. 45-46).

correcting an incorrect tax return would imply a favourable and unequal treatment of taxpayers and, therefore, the principle of equality would be violated.

There might be another cause for unequal treatment as well. Horizontal monitoring is aimed at building trust and enhancing mutual cooperation. However, close(r) cooperation between taxpayers and the NTCA might entail the risk of tax inspectors losing their professional distance. The Stevens Committee emphasized that a loss of a critical attitude undermines the concept of horizontal monitoring. Also, the OECD has rightly stressed the importance of providing assurance to external stakeholders ('wider society') about the impartiality and professional quality of the tax administration.⁴¹ This is called the 'risk of attachment' – also known as the 'risk of regulatory capture'. The Stevens Committee advocated an adequate policy to diminish these risks, for example by rotating the NTCA's staff, by cross-reviewing files of taxpayers that have engaged in horizontal monitoring, or separating duties (Croley, 2008; Stevens Committee, 2012). By doing so, it is prevented that a good relationship and mutual understanding would jeopardize a critical attitude.⁴²

Another legal question is whether the need to disclose all information and legal positions to the NTCA – as part of the HM-relationship – falls within the boundaries of the existing legal framework in the Netherlands. Based on the covenant, taxpayers 'have to voluntarily' – an oxymoron – and proactively provide information to the NTCA. Moreover, taxpayers have to share their views on the tax positions in order to enable the tax inspector to provide legal assurance (certainty to the taxpayer). Normally, the 'fair play principle' does not allow the NTCA to request documents containing legal positions (*e.g.*, a tax advice or due diligence report). Taxpayers have the legal privilege to keep those legal opinions and documents for themselves.

Covenants are only concluded with taxpayers who are willing to voluntarily comply and act transparently in a trust-based relationship with the NTCA. As part of this relationship essential legal privileges have to be waived, *i.e.* the right to confidentiality of legal opinions and documents, have to be waived. Although well-informed multinational taxpayers are free and capable to make such a trade-off between legal rights and legal certainty, we find it captivating that individual taxpayers have to give up essential legal rights in order to receive a cooperative treatment by the NTCA that could be regarded as a 'normal' (and equal) treatment.

And how are HM-taxpayers treated that take a (favourable) stance based, for example, on a strict interpretation of the law? Is it justified that the NTCA tells the taxpayer that such a position threatens the trust relationship and that such a stance should not be taken by taxpayers within the

⁴¹ OECD (2013, p. 65): 'Failure to maintain a professional critical attitude could have a damaging effect on overall confidence in revenue bodies'.

⁴² Cf. Garofalo (2011, p. 25), who points at 'the pervasive tendency in public organizations toward conflict avoidance'.

horizontal monitoring framework? Or even, that such a position would lead to the termination of the covenant? In our opinion, the principle of fair play does not allow the tax inspector to threaten to terminate the covenant, but no (legal) guarantees can be offered in this respect.

As Poolen (2011, p. 178), one of the promoters of HM within the NTCA, noted: in principle, under the covenant, it is possible that parties come to the conclusion that they continue to disagree on the position that the taxpayer has taken ('agree to disagree').⁴³ A covenant tax return may therefore include a position which can be reasonably advocated by the taxpayer and which position is not shared with the inspector. But how to deal with the situation in which the tax inspector believes that the taxpayer is engaging in tax avoidance and/or aggressive tax planning? Because the taxpayer has to be completely transparent, it is not hard to imagine that a situation arises in which the tax inspector may find that the HM-counterpart is not paying a fair share. Although this 'human' reaction might be understandable, this is clearly a moral position. We strongly doubt whether this is a valid reason to terminate the covenant. As long as taxpayers are acting in a transparent and trustworthy manner, it is up to the taxpayers' discretion to arrange his fiscal affairs as he wishes.⁴⁴

The principle of fair play therefore does not allow the tax inspector to terminate the covenant if he is displeased with a (proposed) tax structure. An exception may occur when an HM-taxpayer consciously explores the boundaries of the tax law by repeatedly (slightly) modifying a presented structure that was already declined by the tax inspector. Furthermore, if a taxpayer continuously makes use of aggressive tax planning structures, repressive enforcement should be employed (Poolen, 2011).

5. Conclusions

Behavioural insights promise useful opportunities for designing compliance-enhancing strategies. The NTCA already implements instruments based on a psychological nature within its service-based approach. These instruments carry the key features of 'nudges' and can be called 'tax nudges'. In this paper various types of nudging in the environment of tax administration were demonstrated and discussed: (i) the blue envelope, (ii) the PTR and (iii) horizontal monitoring.

From a legal perspective 'stronger' freedom-restricting nudges that apply to the Automatic System – such as the PTR and horizontal monitoring – can interfere with legal principles that guarantee taxpayers' rights. The authors advocated that some aspects of these compliance-enhancing instruments conflict with the legal principles of equality, fair play and legitimate

⁴³ Thus, when a taxpayer lodges an appeal because his disagreement with the tax inspector on some interpretation is insurmountable should not be seen as a token of distrust. It need not be seen as undermining the trust relationship, and therefore, a reason to terminate the covenant.

⁴⁴ The Minister of Finance answers accordingly to questions by the Dutch Parliament. See Letter of 1 July 2010, nr. DGB2010/2996, *Vakstudie Nieuws* 2010/31.2.

expectations. Because tax nudges are being used in a legalized environment various legal questions arise. Concrete legal questions have been demonstrated by showing different examples in the field of the PTR and horizontal monitoring.

With regard to the PTR it has been observed that the nature of the PIT may gradually shift from an 'administrative assessment tax' to a 'self-assessment tax'. The PTR – started as a tool to 'make it easier' – could in the long run even change the level of taxpayers' protection. It has further been demonstrated that the existing tax assessment system, which requires the tax inspector to assess a tax return before a tax assessment is issued, conflicts with the principle of legitimate expectations. Default positions in the PTR are meant to make it easier to file an income tax return but can promote the existence of errors that taxpayers cannot be aware of. Based on the GTA and case law, it is not always possible to correct a mistake or incorrectness that results from the use of the PTR system. In those cases taxpayers' legitimate expectations outweigh the principle of legality, and, more specifically with regard to an additional assessment, the principle of legal certainty outweighs the principle of equality.

Regarding horizontal monitoring, the principle of equality plays an important role. Inequality between taxpayers created by negotiating and concluding covenants should be prevented. Furthermore, horizontal monitoring holds the risk of regulatory capture, because the relationship between the NTCA and taxpayers becomes too close. In addition, some of the requirements that taxpayers have to meet on engaging in a horizontal monitoring relationship clearly go beyond the statutory obligations imposed on taxpayers.

We argue that behavioural insights offer promising opportunities to increase trust in the NTCA and can be easily integrated in the service-based compliance approach. However, several legal questions remain unanswered and new questions arise. It is argued that when designing strategies to improve tax compliance, those questions should be addressed and worked out – preferably in advance – within a legal framework derived from the legal principles. Legal concerns should be part of a behavioural informed strategy impact assessment before new 'tax nudges' are deployed by the NTCA.

References

- Alemanno, A., & Sibony, A. L. (2015). The emergence of behavioural policy-making: A European perspective. In A. Alemanno, & A.-L. Sibony (Eds.). *Nudge and the Law: A European Perspective* (pp. 1-25). Oxford and Portland: Hart Publishing.
- Alemanno, A., & Spina, A. (2014). Nudging legally: On the checks and balances of behavioral regulation. *International Journal of Constitutional Law*, 12, 429-456.

- Berlin, I. (1969). Two concepts of liberty. In I. Berlin (Ed.). *Four Essays on Liberty*. Oxford: Oxford University Press.
- Baldwin, R. (2014). From regulation to behaviour change. Giving nudge the third degree. *The Modern Law Review*, 77, 831-857.
- Boer, J. P. (2013). Steering taxpayers: A monstrosity? Legal remarks on tax law instrumentalism and 'tax nudging' [original title: Sturende belastingheffer een monster? Juridische kanttekeningen bij fiscaal instrumentalisme en 'tax nudging']. Inaugural lecture Leiden University. Den Haag: Sdu.
- Bogenschneider, B. N. (2017). A 'fool' and his sugar-sweetened beverage are soon taxed. *Liverpool Law Review*, 38, 207-230.
- Bokhorst, M. (2015). Strategies of the Dutch legislator to stimulate autonomy and decrease bureaucracy. *Tilburg Law Review*, 20, 168-179.
- Croley, S. P. (2008). *Regulation and Public Interests: The Possibility of Good Regulatory Government*. Princeton: Princeton University Press.
- Evans, C. (2008). Taxation compliance and administrative costs: An overview. In M. Lang, & C. Obermair (Eds.). *Tax Compliance Costs for Companies in an Enlarged European Community*. Alphen aan den Rijn: Kluwer Law International.
- Filipczyk, H. (2017). *Tax Avoidance and Rationality of Law*. Warsaw: Wolters Kluwer.
- Fonseca, M. A., & Grimshaw, S. B. (2017). Do behavioural nudges in prepopulated tax forms affect compliance? Experimental evidence with real taxpayers. *Journal of Public Policy & Marketing*, 36, 213-226.
- Frey, B. (2003). Deterrence and tax morale in the European Union. *European Review*, 11, 385-406.
- Gangl, K., Hofmann E., & Kirchler, E. (2012). Tax Authorities' Interaction with Taxpayers: Compliance by Power and Trust. WU International Taxation Research Paper Series No. 2012-06.
- Garofalo, C. (2011). Governance and values in contemporary public service. In M. S. de Vries & P. S. Kim (Eds.). *Value and Virtue in Public Administration: A Comparative Perspective* (pp. 17-32). Basingstoke/New York: Palgrave.
- Gribnau, H. (2012). Legislative instrumentalism vs. legal principles in tax law. *Rivista di Diritto Tributario Internazionale*, 3, 9-42. Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2445038
- Gribnau, H. (2014). Not argued from but prayed to. Who's afraid of legal principles? *eJournal of Tax Research*, 12, 209-213. Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461247

- Gribnau, H. (2015). Horizontal monitoring: Some procedural tax law issues. In R. Russo (Ed.). *Tax Assurance* (pp. 183-216). Deventer: Kluwer. Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2608841
- Happé, R. H. (1996). *Three Principles of Taxpayers' Legal Protection* [original: Drie beginselen van fiscale rechtsbescherming]. Deventer: Kluwer.
- Huiskers-Stoop, E. A. M., & Gribnau, J. L. M. (2018, forthcoming). Co-operative compliance and the Dutch horizontal monitoring model. *Journal for Tax Administration*.
- James, S. (2017). Taxation and nudging. In M. Altman (Ed.). *Handbook of Behavioural Economics and Smart Decision-making: Rational Decision-Making within the Bounds of Reason* (pp. 317-330). Cheltenham: Edward Elgar.
- John, P., Cotterill, S., Richardson, L., Moseley, A., Stoker, G., Wales, C., & Smith, G. (2013). *Nudge, Nudge, Think, Think: Experimenting with Ways to Change Civic Behaviour*. London: Bloomsbury.
- Kahneman, D. (2011). *Thinking Fast and Slow*. New York: Farrar Straus and Giroux.
- Kirchler, E. (2007). *The Economic Psychology of Tax Behaviour*. Cambridge: Cambridge University Press.
- Kirchler, E., Hoelzl, E., & Wahl, I. (2008). Enforced versus voluntary tax compliance: The "slippery slope" framework. *Journal of Economic Psychology*, 29, 210-225.
- Ly, K., & Soman, D. (2013). Nudging Around the World. Research Report Series, University of Toronto. Available from https://rotman.utoronto.ca/-/media/Files/Programs-and-Areas/behavioural-economics/Nudging%20Around%20The%20World_Sep2013.pdf
- McCaffery, E. J. (2014), Behavioural economics and the law: Tax. In E. Zamir, & D. Teichman (Eds.). *The Oxford Handbook of Behavioural Economics and the Law* (pp. 599-622). Oxford: Oxford University Press.
- McKerchar, M. (2001). *The Impact of Complexity upon Tax Compliance: A study of Australian Personal Taxpayers*. Sidney: Australian Tax Research Foundation.
- McKerchar, M. (2007). Tax Complexity and its Impact on Tax Compliance and Tax Administration in Australia. Proceedings of the 2007 IRS Research Conference/The IRS Research Bulletin. Available from www.irs.gov/pub/irs-soi/07resconfmckerchar.pdf
- Morgan, B., & Yeung, K. (2007). *An Introduction to Law and Regulation: Text and Materials*. Cambridge: Cambridge University Press.
- Neumann, R. (2015). The devil is in the details: four remarks on the legitimacy of choice architecture. In A. Kemmerer, C. Möllers, M. Steinbeis, & G. Wagner (Eds.). *Choice Architecture in Democracies: Exploring the Legitimacy of Nudging* (pp. 197-218). Baden Baden: Hart Publishing and Nomos.

- OECD. (2004). *Managing and Improving Tax Compliance*. Paris: OECD Publishing.
- OECD. (2006). *Strengthening Tax Audit Capabilities: General Principles and Approaches*. Information Note. Paris: OECD Publishing.
- OECD. (2010). *Understanding and Influencing Taxpayers' Compliance Behaviour*. Paris: OECD Publishing.
- OECD. (2012). *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises*. Paris: OECD Publishing.
- OECD. (2013). *Co-operative Compliance: A Framework: From Enhanced Relationships to Co-operative Compliance*. Paris: OECD Publishing.
- OECD. (2015). *Tax Administration 2015. Comparative Information on OECD and Other Advanced and Emerging Economies*. Paris: OECD Publishing.
- OECD. (2017). *Behavioural Insights and Public Policy. Lessons from Around the World*. Paris: OECD Publishing.
- Oliver, A. (2015). Nudging, shoving, and budging. Behavioural economic-informed policy. *Public Administration*, 93(3), 700-714. doi:10.1111/padm.12165
- Poolen, T. W. M. (2011). Making control horizontal: Changing relationships [original title: 'Horizontalisering van het toezicht: veranderingen in de verhoudingen']. In H. Gribnau (Ed.). *Principieel belastingrecht* (pp. 173-183). Liber Amicorum Richard Happé, Nijmegen: Wolf Legal Publishers.
- Reisch L. A., & Sunstein C. R. (2016). Do Europeans like nudges? *Judgement and Decision Making*, 11, 310-325.
- Soler Roch, M. T. (2012). Tax Administration versus taxpayer: A new deal? *World Tax Journal*, 4.
- Stevens, L. G. M. (2009). Administration of justice anno 2009 [original title: Rechtsbedeling anno 2009]. *Weekblad Fiscaal Recht*, 33.
- Stevens Committee. (2012). Tax supervision – Made to Measure: Flexible When Possible, Strict Where Necessary. The Hague: Ministry of Finance. Available from https://belastingdienst.nl/wps/wcm/connect/bldcontenten/themaoverstijgend/brochures_and_publications/tax_supervision_made_to_measure
- Stewart, M. (2013). Global tax information exchange networks: Legitimacy in a global administrative state. In Y. Brauner, & M. Stewart (Eds.). *Tax, Law and Development* (pp. 316-344). Cheltenham: Edward Elgar.
- Sunstein, C. R. (2014). *Why Nudge? The Politics of Libertarian Paternalism*. London: Yale University Press.

- Sunstein, C. R. (2015). The ethics of choice architecture. In A. Kemmerer, C. Möllers, M. Steinbeis, & G. Wagner (Eds.). *Choice Architecture in Democracies: Exploring the Legitimacy of Nudging* (pp. 21-74). Oxford/Baden-Baden: Hart Publishing and Nomos.
- Sunstein, C. R., Reisch, L. A., & Rauber, J. (2017). A worldwide consensus on nudging? Not quite, but almost. *Regulation & Governance*, 12, 1-20. Available from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2955693
- Thaler, R. H., & Sunstein, C. R. (2008). *Nudge. Improving Decisions About Health, Wealth and Happiness*. New Haven & London: Yale University Press.
- Tversky A., & Kahneman, D. (1974). Judgment under uncertainty: Heuristics and biases. *Science*, 185, 1124-1131.
- Van Aaken, A. (2015). Constitutional Limits to paternalistic nudging: A proportionality assessment. In A. Kemmerer, C. Möllers, M. Steinbeis & G. Wagner (Eds.). *Choice Architecture in Democracies: Exploring the Legitimacy of Nudging* (pp. 161-195). Oxford/Baden-Baden: Hart Publishing and Nomos.
- Van der Hel-van Dijk, L., & Pheijffer, M. (2012). A tailor-made approach to fiscal supervision: An evaluation of horizontal monitoring. *Bulletin for International Taxation*, 66(10), 578-581.
- Veldhuizen, R. (2015). Cooperative compliance: Large businesses and compliance management. In R. Russo (Ed.). *Tax Assurance* (pp. 135-162). Deventer: Kluwer.
- Vording, H. (2012). The concept of instrumentalism in tax law. *Coventry Law Journal*, 18, 41-60. Available from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2745804
- Webley, P. (2004). Tax compliance by businesses. In Hans Sjögren & Göran Skogh (Eds). *New Perspectives on Economic Crime* (pp. 95-126). Cheltenham: Edward Elgar.
- Wenzel, M. (2005). Motivation or Rationalisation? Causal Relations Between Ethics, Norms and Tax Compliance, ANU/Centre for Tax System Integrity Working Paper 63.
- Yeung, K. (2012). Nudge as fudge. *The Modern Law Review*, 75, 122-148.