

IOTA PAPER

20
22
DECEMBER

**AN INNOVATIVE MEAN FOR IMPROVING
VOLUNTARY FISCAL COMPLIANCE BY
SHARING TRANSPARENCY**

OR HOW PREVENTIVE LETTERS HAVE
BROUGHT IN ANOTHER 2 BILLION IN
TAX COLLECTION

Stefano Latini, Italian Revenue Agency



IOTA

Intra-European Organisation
of Tax Administrations

The Italian Revenue Agency is moving ahead swiftly on the transmission of alerts, or preventive communications, reporting anomalies to taxpayers and empowering them to decide whether to proceed with self-corrections. Without accompanying the notice with an ordinary and imperative recovery act, the letters aim at favoring a spontaneous fiscal compliance. To May 2022, therefore in just five months from the beginning of the year, nearly two billion of taxes due, but not yet paid, had been recovered by the Revenue Agency thanks to compliance letters. In addition, also the Italian *National Recovery and Resilience Plan* (NRRP) has transposed this soft strategy and its goals, in the chapter expressively dedicated to the tax administration reform. A vast cooperative compliance strategy through which, till August 2022, nearly 1.9 million compliance notices had been sent to as many taxpayers. That is for the first 8 months of 2022. Indeed, these numbers take a snapshot of the latest results of a new and innovative strategy, centered on the core principles of *cooperative compliance*, adopted in 2015-2016 and now fully in place after having experienced its various testing phases necessary to reach the current levels of reliability and quality that these data certify. Below we will explain what this new strategy, now fully included amongst the agency's instruments, consists of.



A newly approach in stimulating and fostering taxpayers compliance

Let us start from the beginning. In Italy, as in many other Countries, efforts to reduce non-compliance have historically focused on audits and control, which may result in assessments with no comprehensive strategy. In the light of this trend, it has become evident that there was a deep need to reform the old tax enforcement scheme adopting a new vision inspired by the principles of an innovative cooperative compliance strategy. In this changed scenario, the preventive communications, or tax alerts, addressed to taxpayers not properly in line with their fiscal obligations, have become a symbol of a reformed instrument aimed at generating significant behavioral change, by both taxpayers and tax administration. Since then, growing consideration has been given to issuing compliance letters to taxpayers, identified as outliers, indicating that an under-declaration has been made and inviting them to review their tax returns and file amended returns.

Year	Letters sent	Amounts collected
2022 – To August	1,9 million	2 billion – To May
2019	2,13 million	2,13 billion
2018	1,9 million	1,8 billion
2017	1,45 million	1,3 billion

*In 2022, the figures refer to the first 8 months in relation to compliance letters sent and to the first 5 months in relation to taxes spontaneously recovered thanks to preventive notifications

**In addition, the two-year period 2020-21 does not appear in the table because the sending of letters had been suspended due to the pandemic

Taxpayers' options after receiving the preventive communications

Taxpayers who received compliance letters can regularize any reported error or omission through the "*Ravvedimento operoso*" that is a specific procedure that allows to voluntarily correct tax returns, if there is a mistake or an oversight, with a smaller penalty. On the other hand, if the taxpayer considers the data reported in the tax return to be correct, it will be sufficient to notify all useful elements, facts and circumstances yet not known to the Revenue Agency. This approach, based on a reciprocal sharing of transparency between the Tax Administration and citizens, is designed, as the results showed, to gain a better compliance *advantage* in respect to taxpayers at higher risk of tax evasion and non-compliance.

Risk-analysis, not only theory, behind the success of tax alerts

Therefore, sending letters represents the finalization of a tailored intervention based on a risk-based approach and supported by the massive use of advanced analytics, like Artificial Intelligence, AI. In synthesis, the increasing use of advanced analytics makes it possible to use all the information revenue bodies have about taxpayers to accurately target those taxpayers "*with the right intervention at the right time*", not too late when demanding to revise the wrong fiscal behavior already put in practice by taxpayers is almost impossible to obtain. Thus, matching the pillars of an innovative compliance theory with new practical technology leads to the elimination of costs correlated to ineffective interventions and, on the other side, to the improvement of recovered revenue flow arising from taxpayers who decide to regularize their fiscal positions accepting the tax warning contained in compliance letters. Advanced analytic techniques also make it possible to experiment with different interventions and quickly assess their effectiveness.

Secures improved voluntary compliance by selecting taxpayers. How does it work?

In this regard, it should be recalled that the Italian NRRP has indicated a 20 percent increase in compliance letters as a goal to be achieved by the Revenue Agency. To achieve this goal, the Tax Administration, as mentioned in the report filed by the government in Parliament, has planned the criteria for preparing accurate lists of taxpayers towards which to activate compliance stimulus initiatives. The detection of taxpayers at high risk of evasion is conducted by using new high-tech tools and data analysis capabilities. Particularly, for each list, the target audience and the period of the year in which compliance notices will be sent to selected taxpayers are indicated.

Quantity but also quality

There is a further key step in the NRRP that requires to increasingly refine the spontaneous compliance strategy to flush out the real evaders. In brief, the NRRP calls for the reduction of "false positives" by 5 percent. Indeed, it is about making sure that compliance letters are sent to individuals who have surely made omissions or errors and not to taxpayers in good standing. Not least because, in this last case, the "taxpayer oriented" strategy of the Revenue Agency" would actually prove to be a boomerang. According to information provided by the Tax Administration to the Government for the finalization of the report to the Houses of Parliament, false positives have been reduced to 5.025, representing only 0.3 percent of the letters transmitted. The figure is updated as of last August 30 2022. Of course, containing the figure of false positives required an outstanding "preparatory" work. Each information cross-referencing criterion is subject to a preliminary testing phase to allow for the identification of possible anomalies in the target audiences such as, among others, the presence of special taxation regimes. An intense verification that continues until each "package" of communications is sent to targeted taxpayers lists.

History of a success thanks to the matching of nudge principles, behavioral economics insights, cooperative compliance adoption and advanced technology tools – Indeed, behind the achievements obtained by tax letters, there are several insights that, once embraced, met and somehow merged within a new regulatory architecture of cooperative compliance that can inform a vast range of activities and strategies conducted by Tax Administration with a good guarantee of success. A strategy, as mentioned above, that is innovative in putting into practice those principles derived from behavioral economics thinking and, particularly, from one of its most famous applications, the nudge theory. It could seem extremely complicated, yet if you look to these theories in the way they work, the whole scenario becomes clearer and more readable. Fundamentally, the field of behavioral insights is focused on understanding human decisions and behaviors, then leveraging those insights to design practical policies and interventions. Regarding tax administration, it can be beneficially applied to a wide range of areas, from taxpayer services and enforcement to internal topics such as employee engagement and productivity. In this Paper we have looked at how insights can positively affect and stimulate a voluntary fiscal compliance behavior by taxpayers. In this regard, the preventive communications sent to remind taxpayers to fulfil their fiscal obligations represents an almost perfect tool through which to analyze and observe how using behavioral insights and nudge solutions can be beneficial to Tax Administrations in securing and implementing taxpayers' compliance. Yet, to make effective this

compliance approach, it is also necessary to inform the strategy with modern data and high-tech platforms. In fact, the universes of data collected instantaneously by the Revenue Agency expect to be intelligently screened and selected before becoming concretely valuable in implementing the tax compliance on a voluntary base.