Audit versus Detection Probabilities:
A Conceptual and Empirical Investigation of Taxpayers' Perceptions

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Abstract

Detection probability has consistently been associated with taxpayer compliance behavior in both theoretical and empirical studies. Yet, very little is known about how taxpayers assess detection risks using information they have. This study explores the accuracy of taxpayers' perceptions, and the extent to which taxpayers distinguish between audit and detection probabilities. It also provides some insight into factors that influence taxpayers' detection probability perceptions. The research employs a combination of a policy Delphi study to estimate actual audit and detection probabilities and a survey administered to individual taxpayers to measure their perceptions.

Although historical tax audit rates (for in-person audits) are published, providing a measure of overall audit probability, disaggregated audit rates are not published by the IRS. In addition, *detection* probability is even more difficult to assess than audit probability because detailed data about the percentage of returns targeted for IRS action by means other than audits is unavailable. In this study, a Delphi panel of tax experts was used to obtain estimates of these variables from experienced tax practitioners whose dealings with the IRS make them knowledgeable about IRS enforcement procedures and provide them with many data points upon which to base their estimates. The survey elicited taxpayers' perceived audit and detection probabilities for their own tax situation and for the same three hypothetical tax scenarios used in the Delphi study.

A total of 166 subjects participated in the survey phase of the study. The taxpayer subjects knew that noncompliance is more likely to be detected when it is related to income subject to third party reporting. However, they consistently misestimated detection rates for all three different types of noncompliance examined in this study. With respect to the difference between audit and detection probabilities, the subjects distinguished between overall audit and detection probabilities and recognized the distinction in one of the noncompliance cases. However, for two noncompliance scenarios, the taxpayer subjects perceived that audit and detection rates are about the same.

Additional analyses were conducted to examine the impact of tax advisors and social networks on taxpayers' detection probability perceptions. The paper concludes with a discussion of implications for further research and for tax policy.