



Tax morale and tax evasion reports



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HIGHLIGHTS

- New measure of tax morale based on voluntary reports of tax evasion.
- Positive relationship between tax morale and social capital.
- Positive relationship between tax morale and immigration.
- Negative relationship between tax morale and dissatisfaction with public services.

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ABSTRACT

The study proposes a new measure of tax morale for Italy based on voluntary tax evasion reports. Using this measure, I detected a positive relationship between tax morale and social capital, political participation, and immigration, but a negative relationship between tax morale and the dissatisfaction with public services and unemployment.

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1. Introduction

The concept of tax morale was introduced in the economic literature to provide a rational explanation of why people pay taxes (Slemrod, 2007). This was because traditional models of tax evasion Allingham and Sandmo (1972), which are based only on auditing probabilities and expected penalties, underestimate the empirically observed rate of tax compliance significantly (Andreoni et al., 1998; Feld and Frey, 2002; Sandmo, 2005). Thus, in an attempt to reconcile the model with the data, several authors have hypothesized the existence of a moral (Erard and Feinstein, 1994) or intrinsic motivation (Frey, 1997) for paying taxes, which was designated as “tax morale”.

Previous empirical studies have constructed several measures of tax morale based on a variety of surveys: the International Social Survey Program (Torgler, 2005b), the World Values Surveys (Alm and Torgler, 2006; Torgler, 2006), the European Values Surveys (Lago Peñas and Lago Peñas, 2010; Hug and Spörri, 2011), the British Social Attitudes Survey (Orviska and Hudson, 2002), the

Latinobarometro (Torgler, 2005a), and the Afrobarometer (Cumings et al., 2009). Typically, tax morale has been measured as the percentage of survey respondents who agree with statements such as: “Citizens should not cheat on their taxes”, “Cheating on taxes is justifiable if there is the opportunity to do so”, or “Managing to avoid tax payments is legitimate”.

In this study, I propose a new measure of tax morale, which is based on quasi-experimental data: the voluntary reports of tax evasion collected in Italy via a website evasori.info. This site allowed users to report transactions that lacked a receipt, so were hidden from the tax authority and allowed the supplier to evade taxes. It was expected that buyers who are averse to tax evasion would report such episodes, possibly as a form of social sanction, which may or may not be related to other possible social sanctions, such as exclusion from communal activities, thereby acting as a negative advertisement and causing sellers to lose customers. In the present study, my measure of tax morale was the number of tax evasion reports per unit of irregular activity given the actual level of irregular activity (which by definition entails tax evasion), so a higher number of tax evasion reports is an indicator of a less lenient attitude toward tax evasion and, therefore, of a stronger tax morale.

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Thus, I conducted an analysis of the determinants of tax morale in Italy. Most of the variables considered have already been discussed previously, i.e., social capital, political participation, working status, education, satisfaction with public services, religion, and demographics. In contrast to previous studies, however, I also considered the relationship between tax morale and immigration in a systematic manner. I found that tax morale was positively associated with social capital, political participation, and immigration, but negatively associated with dissatisfaction with essential public services and unemployment. The most interesting result was the positive association between tax morale and social capital, because involvement in the local community can also foster a locally-oriented subculture, which may oppose national Government contributions and redistribution.

The study belongs to the broad category of studies on tax morale and its determinants. The most closely related work, which was conducted by Cannari and D'Alessio (2007), analyzed opinions on tax evasion and the propensity to evade by addressing specific questions in the Survey on Household Income and Wealth (SHIW), which was administered by the Bank of Italy. They find that self-employed, younger and less educated individuals were more likely to evade taxes, and that this propensity was positively associated with the crime rate and the unemployment rate, but negatively related to social capital. They also found that there was a generally low aversion to tax evasion, which is part of the reason why evasion is so common in Italy. Among other studies, Lago Peñas and Lago Peñas (2010) discussed the relationship between tax morale and the socio-demographic, cultural, and political characteristics of European countries. Alm and Torgler (2006) compared tax morale in the USA and in Europe. Torgler (2005b) and Hug and Spörri (2011) studied the relationship between democratic participation and tax morale in the Swiss Cantons and among countries. The new perspective introduced in the present study is a new measure of tax morale.

The remainder of this paper is organized as follows: Section 2 describes the data, Section 3 summarizes the empirical results, and Section 4 provides the conclusions.

2. Measuring tax morale

I constructed a measure of tax morale, which was based on voluntary reports of tax evasion submitted to an Italian website evasori.info. The website allowed anyone to submit anonymous reports of their transactions with sellers who failed to issue receipts, thereby evading taxes. These details included the amount of the transaction, the geographic location, and the type of economic activity conducted by the seller (a choice was made from a long list). The concept behind my measure of tax morale was that with the same level of tax evasion, a higher number of tax evasion reports would suggest a higher frequency of social sanctions against this behavior, so it could be used as an indicator of a more negative attitude toward tax evasion. To control for the actual level of tax evasion, I used the rate of irregular activity reported in the Italian Statistical Institute (ISTAT) database. One problem with this measure was that it was only available at the region level (21 observations), whereas the tax evasion reports were available at the province level (102 observations). ISTAT also reports a rate of irregular activity, which is disaggregated into economic activity categories, so I constructed a measure of irregular activity at the provincial level by computing a weighted average of the irregular rates for different activities, where the weights equated to the share of activities in the province. I obtained my measure of tax morale by dividing the total number of reports in a given province by this irregular activity rate.

The empirical distribution of my tax morale measure was positively skewed, which reflected the presence of a few large

outliers. The mean number of reports per unit of irregular activity was 4.4 and the median was 1.7. The highest value in the sample was 70 (Roma) while the lowest was 0.1 (Vibo Valentia). The standard deviation was 9.5. Excluding the top two observations in the sample (greater than 20 times the median value), I arrived at a mean of 3.2, a standard deviation of 3.8, and a range of 23. My tax morale measure also had high geographic variability, i.e., among the lowest 10 (20) observations, only one (five) belonged to a province in Northern Italy, whereas only one (two) of the top 10 (20) observations belonged to a province in Southern Italy.

In my opinion, there are three major problems with my tax morale measure. The first is the interpretation of zeros, i.e., the absence of reports. They could indicate the absence of tax evasion, which may or may not be a consequence of an extremely high tax morale. Alternatively, they could be a sign of a particularly low level of tax morale where evasion is much easier due to a lack of social pressure. Two elements significantly reduced the importance of this ambiguity. First, there were no zeros in the reports dataset and there was a high correlation between population size and the number of reports at the level of the province (0.61). Second, zero tax evasion was never observed in the irregular activity dataset.

The second major problem was that the anonymity of reports meant that it was not possible to control for the frequency of reports by the same users. Thus, my measure could have been based on a small number of reports made by a very large sample of users or a large number of reports made by a small sample of users. The problem is that tax morale will potentially have stronger effects on all outcomes if it is more widespread, because this means there is a higher probability of being matched with an individual with a high tax morale during an economic transaction. However, this is only true if we assume an equal number of transactions per individual. Instead, if the number of reports is proportional to the number of transactions, the magnitude and diffusion of tax morale are highly correlated. Thus, I assumed that the individuals who made fewer reports simply had fewer opportunities to make reports.

The third problem was related to the interpretations of the reports. Based on the information captured via the website, it is not clear whether they were reports of actual or possible tax evasion. For example, we might consider a case where a seller tries to complete a transaction without issuing a receipt but the buyer notices this and asks for a receipt, thereby preventing tax evasion, yet the buyer still reports the transaction via the webpage. For the purposes of my analysis, there was not a big difference between reports of actual or potential evasion because they are indicators of a negative social attitude, where an individual sanctions the behavior of an (actual or potential) evader. The only difference is that, if the reports only described potential tax evasion, I must refrain from any interpretation of the total level of evasion because the amounts would have been disclosed to the tax authority eventually.

Another, perhaps less important, problem is that my measure might be more volatile than tax morale itself. Indeed, a higher tax morale is associated with a lower level of tax evasion and a higher number of reports, which indicates a higher numerator and a small denominator in my measure.

3. Determinants of tax morale

What are the possible explanations of tax morale? I performed regressions of my tax morale measure on most of its determinants that have been highlighted in previous studies. The effects were validated based on the variability at the level of the Italian provinces.¹ An important additional source of validation was

¹ I used the classification of provinces at the time the website evasori.info was created, which was before the two institutional reforms that first increased (2004) and then decreased (2012) the number of provinces.

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