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Voluntary disclosure of evaded taxes — Increasing revenue, or increasing incentives to evade?☆

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ABSTRACT

Many countries apply lower fines to tax evading individuals when they voluntarily disclose the tax evasion they committed. I model such voluntary disclosure mechanisms theoretically and show that while such mechanisms increase the incentive to evade taxes, they nevertheless increase tax revenues net of administrative costs. I confirm the importance of administrative costs in a survey of German competent local tax authorities. I then test the effects of voluntary disclosure on the tax evasion decision, using the introduction of the 2009 offshore voluntary disclosure program in the U.S. for identification. The analysis confirms that the introduction of voluntary disclosure increases tax evasion.

1. Introduction

Households worldwide hold about 8% of their total financial wealth, almost U.S.-$ 6 trillion, in tax havens (Zucman, 2013). Correspondingly, tax authorities forego high tax revenues: The United States loose tax revenues of around $ 70 billion annually because of personal income tax evasion via offshore accounts (Gravelle, 2009). The need for tax revenues in the wake of the financial crisis has now rekindled governments' efforts to curb such income tax evasion.

Principally, governments can fight tax evasion by individuals who hold their wealth offshore in two ways. First, they can negotiate with tax havens to share information regarding foreigners' accounts. An example is the recent agreement between the United States and Switzerland forcing Swiss banks to provide information on accounts owned by U.S. citizens. However, such treaties are not very effective, as tax evaders rather shift their funds to another tax haven instead of repatriating them (Johannesen and Zucman, 2014). Second, governments can set incentives for individual taxpayers to declare foreign wealth and the tax evaded on it.

Many countries incentivize individuals to come clean with "voluntary disclosure" programs. Such programs require individuals to report all their foreign asset holdings. The income on these assets is then taxed retroactively at the standard tax rate, but no or a reduced fine is levied. Only individuals not yet under investigation for tax evasion can make use of these programs. Voluntary disclosure programs exist in many countries (see Table 1 for an overview), and are often part of the general law and valid for an unlimited period. However, some commentators fear that the option of voluntary disclosure increases the incidence of tax evasion, as these programs offer the possibility to escape high punishments if individuals feel that the probability of detection has increased.

The economic literature has so far barely studied voluntary disclosure programs. Using both a theoretical model and empirical tests, the paper aims to shed some light on this topic. First, I ask how the existence of a voluntary disclosure program affects individuals' tax evasion decision. In both the theoretical model and the empirical test I show that the existence of such a program increases tax evasion. Second, I consider the government's point of view, studying whether the tax authorities should offer voluntary disclosure, despite the increase in tax evasion it causes. In my model, governments should offer voluntary disclosure only when a disclosure lowers the administrative costs related to

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Table 1
Voluntary disclosure in OECD countries.

Country	Legal basis	Tax & interest		Penalty	
		Tax	Interest	Monetary	Imprisonment
Australia	General law	Full amount	Varies	Varies	Possible
Austria	General law	Full amount	2.38%	No	No
Belgium	General law	Full amount	7.00%	0–10% of tax	No
Canada	General law	Full amount	Yes	No	No
Chile	General law	Full amount	1.50%	10–300% of tax	≤15 years
Czech Rep.	General law	Full amount	Ca. 15%	No	No
Denmark	General law	Full amount	Varies	50% of tax	Possible
Estonia	General law	Full amount	0.06%/day	≤18,000 EEK	Possible
Finland	General law	Full amount	Yes	30% of tax	≤4 years
France	Special program (2009, 2013–14)	Full amount	0.4%/month	Varies	No
Germany	General law	Full amount	6.00%	No	No
Greece	Special program	5% to 8% of total capital		No	No
Hungary	General law	Full amount	1.5–1.75x std. rate	Only heightened interest	No
Iceland	None	–	–	–	–
Ireland	General law	Full amount	Varies	3–10% of tax	No
Israel	Special program (2011–2012)	Full amount	No	No	No
Italy	General law	Full amount	Varies	Reduced	No
	Special program in 2008	5% of assets		No penalty	
Japan	General law	Full amount	4–14.6%	Varies	≤10 years
Korea	General law	Full amount	0.03%/day	Reduced	Varies
Luxembourg	General law	Full amount	0.6%/month	≤10% of tax	No
Mexico	General law	Full amount	Yes	No	Rarely
	Special program in 2009		4–7%	No	No
Netherlands	General law	Full amount	Varies	≤300% of tax	No
	Special program in 2009, 2013	Same as general law		No penalties	
New Zealand	General law	Full amount	Varies	Reduced	No
Norway	General law	Full amount	Yes	No	No
Poland	General law	Full amount	75% of regular rate	No	No
Portugal	General law	Full amount	4.08%	Reduced	No
	Special program in 2009	5% of discl. assets	None	No	No
Solvak Republic	General law	Full amount	Yes	No	No
Slovenia	General law	Full amount	Increased	No	Possible
Spain	General law	Full amount	Yes	5–20%	No
Sweden	General law	Full amount	Yes	No	No
Switzerland	General law (since 2010)	Full amount	Yes	None, if repeat offender ≥ 20% of tax	No
Turkey	General law	Full amount	Yes	No	No
	Special program in 2009	2% or 5% of tax base		No	No
United Kingdom	General law	Full amount	Varies	Reduced	No
	Special program in 2009/2010	Full amount		10–20% of tax	No
United States	Special program 2009, 2011, 2012	Full amount	Varies	20% of tax, 20–27.5% of offshore balance	No

Table based on information from OECD (2010), updated with information from tax authority and tax consultancy homepages.

assessing taxes of evaders. I then confirm the importance of administrative costs in a survey of German competent local tax authorities and use the acquisition of whistle-blower information in Germany to quantify the revenues brought in by voluntary disclosure. Lastly, I analyze how governments should fine tax evaders after a voluntary disclosure.

In more detail, my theoretical model frames tax evasion as a rational choice of individuals that bear a moral (psychic) cost when evading taxes. There is ex—ante uncertainty about the probability of being caught and fined, and individuals have the possibility to voluntarily disclose the tax evasion they committed after the detection probability is revealed. In equilibrium, the individuals with the lowest moral cost will evade taxes, those with intermediate moral costs will first evade taxes but voluntarily disclose later if the detection probability is high, and those with the highest moral costs will never evade taxes. In this model I show that the existence of voluntary disclosure increases the number of individuals who evade taxes. This result arises as voluntary disclosure allows individuals to better differentiate their actions according to the detection probability.

I later test this result empirically, using the introduction of the first Offshore Voluntary Disclosure Program in the U.S. in 2009 for identification. Employing a synthetic control approach, I analyze how U.S. deposits in offshore banking centers have changed compared to deposits from other countries. This analysis confirms that the existence of a voluntary disclosure program indeed increases tax evasion, in line with the theoretical model.

I also model how the government should employ voluntary disclosure. In the model, voluntary disclosure increases net tax revenue if there are administrative costs of fining tax evaders in the absence of a voluntary disclosure. Voluntary disclosures allow the government to save such administrative costs. The government then sets the fine that applies after a voluntary disclosure to trade off the higher tax evasion with these administrative cost savings. I confirm the importance of such administrative cost savings in a survey among German competent local tax authorities.

Several strands of literature are relevant to this paper. First, there is a large literature on tax evasion by individuals (see Slemrod (2007) for an overview). The theory goes back to Allingham and Sandmo (1972) and Yitzhaki (1974), who model tax evasion analogous to portfolio choice. Sandmo (2005) provides a review of this line of literature. Despite the obvious difficulties to measure tax evasion, there is also a large empirical literature, which Alm (2012) summarizes.

To my knowledge, no paper studies a voluntary disclosure program as described above. However, there is some literature on tax amnesties, which are short-run programs (often about three months long) that usually do not fine tax evaders. Also in contrast to voluntary disclosures, tax amnesties often include those already under investigation for tax evasion and allow only a partial reporting of prior tax evasion. In this literature, Malik and Schwab (1991) propose a model with uncertainty about the disutility from tax evasion to explain why individuals take up the offer of a tax amnesty (which they never would in the standard

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