



# Taking the high road? Compliance with commuter tax allowances and the role of evasion spillovers<sup>☆</sup>



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## ABSTRACT

This paper provides evidence of evasion in the context of a widely used commuter tax allowance, and explores evasion spillovers as a determinant of the individual compliance decision. For this purpose, we exploit discontinuities in the commuter allowance scheme and employ a research design resting on a large panel of individual tax returns. We find that around 30% of all allowance claims are overstated and, consistent with deliberate tax evasion, we observe sharp reactions of taxpayers to thresholds where the allowance discretely jumps to a higher amount. Further, we use variation in job changes to uncover spillover effects from the work environment on the individual compliance decision. These effects appear to be asymmetric: Job changers moving to companies with a higher fraction of cheaters increase their cheating. In contrast, movers to companies with a lower fraction of cheaters tend not to alter their reporting behavior. We provide suggestive evidence that the spillover has more to do with an information environment, but can ultimately not reject other behavioral explanations such as asymmetric persistence of norms.

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## 1. Introduction

It is well documented that, given low audit rates and modest penalties, tax evasion in advanced economies should be much higher than empirically observed (see, e.g., Slemrod, 2007 for an overview).

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Recent research concludes that not only psychological, moral or cultural aspects are responsible for preventing people from cheating but also the lack of opportunity to do so. Notably Kleven et al. (2011), relying on a large scale audit experiment in Denmark, show that third-party reporting effectively inhibits people's possibility to cheat on their taxes while self-reported income is prone to be evaded.

While it is striking how self-reported items are subject to tax evasion, it is interesting to note that there are still many taxpayers not availing this easy opportunity for non-compliance (e.g., Kleven et al., 2011 report non-compliance rates of self-reported income of around 40%). This paper aims to add one explanation to this observation showing that the individual evasion decision is influenced by the compliance behavior at one's work environment. In particular, our results suggest the existence of evasion spillovers, with individuals becoming more likely to start cheating when being exposed to a more non-compliant environment. While there exist empirical documentations of indirect deterrent effects of increased enforcement on the compliance of non-audited taxpayers (e.g., Pomeranz, 2015; Rincke and Traxler, 2011), evidence of complementary evasion spillovers regarding opportunities to cheat is limited to either lab experiments (e.g., Fortin et al., 2007) or some aggregated social externalities (Galbiati and Zanella, 2012). Our paper is the first to

provide field evidence that evasion spillovers might indeed influence the individual compliance decision.

To begin with, we present compelling evidence to the finding that self-reported tax items are prone to be evaded, examining the role deductions play for wage earners to underreport their taxable income. In particular, we focus on the degree of tax evasion via a commuter tax allowance in Austria, compensating employees for their travel-to-work expenses and representing the biggest standard deduction available for Austrian wage earners. This commuter allowance is designed as a step function of the distance between residence and the workplace, creating sharp discontinuities at each bracket threshold. According to the Austrian tax code, employees report their eligibility for a certain distance bracket to the employer who, as the third-party, has to validate these claims and adjusts taxable income before withholding. In practice, however, employers do not sufficiently double-check these claims, turning the allowance into a (quasi-)self-reported item. Since tax authorities do not systematically check whether the self-reported information is accurate, the scheme offers employees an opportunity to overreport their travel distance to work and hence, to receive a tax allowance higher than they are actually entitled to.

To reveal tax evasion regarding commuter allowances, we employ a dataset consisting of merged tax and matched employer-employee panel information from Austria, including earnings information over the whole population of Austrian (private-sector) employees between 1995 and 2005 (about 3 million taxpayers, of which around 725,000 are commuters). Our database includes information on the allowance each taxpayer received as a commuter. It also contains the employer's location and the commuter residence on zip-code level, which allows us to approximate the real driving distance between both locations and the hypothetical commuter allowance the taxpayer should have received. A comparison between the hypothetical allowance and the claimed allowance reveals who misreports the commuter allowance. By doing this, we are in the unique position to track the compliance behavior of each Austrian commuter over a time period of up to ten years.<sup>1</sup>

Our results show that tax evasion via self-reported commuter allowances is substantial. We find that around 30% of all allowance claims are overstated, and, consistent with deliberate tax evasion, we observe sharp reactions of taxpayers who reside close to the thresholds where the allowance discontinuously jumps to a higher amount. This high rate of evasion for a widely used form of tax deduction – more than 30% of all employees with income tax liabilities request this deduction – makes the commuter allowance an ideal laboratory to understand the determinants of tax evasion. First, we examine the impact of socio-demographic variables on individual compliance. In line with previous studies (e.g., Kleven et al., 2011), their impact on the evasion decision is rather limited. In contrast, variables that display the proximity of the taxpayer to a certain bracket threshold and, therefore, capture the opportunity and incentive to overreport, have strong effects on the compliance decision. Further, we take advantage of our data situation that allows us to observe not only the compliance decision of a single taxpayer but also the compliance behavior of his colleagues at the workplace. Indeed, we find that the individual evasion behavior strongly correlates with the evasion behavior of other co-workers within the same firm.

To uncover the causal effect of the work environment on individual cheating, our empirical strategy rests on a sample of job changers moving between employers that differ in the share of workers overstating their commuter allowance. Hence, our identification strategy exploits variation in job changes to reveal spillover

effects from the new work environment on the individual compliance decision.<sup>2</sup> Studying the switching behavior of job movers also accounts for recent research suggesting that optimization frictions such as inattention can lead to sluggish behavioral adjustments (see, e.g., Chetty, 2012). Since moving to a new employer forces taxpayers to reconsider their compliance decision when reporting their new allowance eligibility, it presents a valuable situation to study potential behavioral responses to a new environment.

Turning toward the results obtained from our sample of job movers, we first find a significant impact of a taxpayer's work environment on the individual compliance decision. Second, we observe *asymmetric* effects of increases versus decreases in co-worker cheating shares when individuals move between companies. Specifically, job changers who move to a firm with a higher fraction of cheaters start overreporting much more after they move. In contrast, those who move to firms with a lower fraction of cheaters tend not to change their reporting behavior. This asymmetry in the effect of the job change rejects explanations based on sole firm-level mechanical effects, such as some firms thoroughly screening the commuter allowance claims of their employees while other firm do not. In fact, substantial firm-specific effects on the reporting behavior would not translate into such an asymmetric impact of an individual's previous co-worker cheating share on current behavior. Instead, one would expect changes in overreporting to move alongside with changes in co-worker cheating shares.

The existence of such asymmetric effects of job moves is consistent with models based on the asymmetric persistence of norms as well as with models based on information, memory and learning. The question which of these models are more important in our context is difficult to be settled here. To make progress, we study take-up rates of two other (quasi-) self-reported deduction items employees can file at the firm level. Our results show that job changers who move to high-cheating firms (in terms of the commuter allowance) do not show a higher propensity to start filing for the two other items. In fact, it seems that the impact of a high-cheating work environment is contained to the very item of the commuter tax allowance. While this suggests that a broader corruption of norms may not sufficiently explain the evasion spillover we observe with respect to the commuter allowance, we interpret this result as informative but not conclusive.

Our study adds to the fairly slim literature on tax evasion via personal allowances and provides implications for the design of optimal tax collecting policies. To our knowledge, our paper is the first to provide evidence of evasion in the context of commuter tax allowances – a deduction item available in many countries.<sup>3</sup> Furthermore, our findings corroborate research showing that the responsiveness of taxpayers regarding itemized deductions is sensitive to the design and enforcement of the respective policy item (e.g., Fack and Landais, 2016). Related to this, the case of the Austrian commuter allowance nicely demonstrates the deficiencies of a poorly designed tax (allowance) scheme comprising sharp discontinuities in the deductible amount and an eligibility criteria that is very difficult to verify for the government. Finally, we think that our research design looking at asymmetric effects on the behavior of subgroups of taxpayers (in our case job changers) can also contribute methodologically to a wider body of the compliance literature. It

<sup>1</sup> We complement our findings using exact residence and workplace addresses of about 3500 commuters of a large Austrian retailer. Using this data, we can confirm our findings from the population tax data (see Appendices A.4 and A.5).

<sup>2</sup> Since taxpayers can actually circumvent the employer via filing for the commuter allowance through the tax return at the end of the year, a sorting of taxpayers to certain companies is very unlikely. Hence, we treat the decision to start a new job as exogenous in regard to the compliance decision. In Section 4.1 we address this identifying assumption in detail.

<sup>3</sup> Compensation for travel expenses are sometimes included in general work-related deductions (e.g., France or Italy), designed as a single allowance for commuters (e.g., Germany, Netherlands, Denmark) or come in the form of tax-free benefits paid by the employer (e.g. in the U.S.).

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