Review

Behavioral dynamics of tax evasion – A survey

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A B S T R A C T

Since the 1950s (Schmölders, 1959) it is well known that behavioral aspects have an influence on tax evasion or tax compliance. In particular, interactions among the various entities involved in the taxation process (e.g. taxpayers, law makers, tax practitioners, tax authorities, etc.), and the dynamics that these interactions may generate, seem to play an important role for the actual level of tax compliance. However, the mainstream neoclassical approach to tax evasion (Allingham & Sandmo, 1972) cannot account for such interactions and dynamics. Therefore, during the last two decades new approaches (e.g. lab experiments, agent-based modeling, etc.) have been developed with a view to model how behavioral dynamics may foster or prevent tax evasion. In addition, empirical evidence has been generated that supports a role for such interaction dynamics. In this contribution we survey the main developments in this research area and provide some suggestions for further research.

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† Shortly before this paper could be finished, Michael Pickhardt deceased on October 2, 2012.

1. Introduction

Analyzing non-compliance with taxation duties goes back to the seminal contributions of Allingham and Sandmo (1972), Srinivasan (1973)[1] and Yitzhaki (1974). Since then the topic has received an ever growing interest and today, issues of tax evasion and related aspects such as corruption, money laundering and the shadow economy are relevant for many of the present economic problems.

This notwithstanding, important elements of the decision leading to individual non-compliance with taxation schemes have only recently received some attention. In particular, this is true for the interaction of agents involved in the taxation process and the dynamics which these interactions may generate. Therefore, this contribution is devoted to survey the literature on behavioral dynamics of tax evasion with a view of summarizing its findings and suggesting a future research agenda.

A particular point is noteworthy just at the beginning of this paper. Most studies on tax evasion do not differentiate either with respect to the kind of tax – i.e., whether it is income tax, VAT or any other tax – or with respect to the person or organization evading the tax. In a certain sense, almost always a kind of income taxation seems to be implicitly supposed. In addition, an individual decides whether and how much to evade, which is especially true for laboratory experiments. However, as pointed out by Alm (2012a), p. 55, tax evasion and avoidance is similarly possible with other taxes too. Consequently, research results are relevant for all taxes.

This contribution is organized as follows. In Section 2, we structure the behavioral dynamics of tax evasion as a tax 'game', i.e., the focus is on the interactions between subjects and institutions. In this way, crucial links between these persons and institutions will emerge in a 'natural' way, defined by the institutional setting and the socio-economic embeddedness of taxpaying. Section 3 contains the main results of the various disciplines and approaches of tax compliance research. The discussion in Section 4 is intended to consolidate the main findings and to hint at blind spots and holes of research. Section 5 concludes.

2. Tax evasion and the modeling of behavioral dynamics

2.1. Tax game: the big picture

In this section, the structure and interdependence of the relationship between taxpayers, tax authorities and tax practitioners[2] are analytically described. This depiction is a kind of upshot of the existing literature on tax evasion and compliance. To present the whole picture and to avoid the risk of missing the main points because of too many details, we deliberately abstain from quotations to a very large extent. Nevertheless, in Section 3 those contributions are quoted which have been so far crucial for our view of the subject matter.

Tax compliance as well as tax avoidance and evasion are processes in which individuals interact directly or indirectly with each other. However, since taxation is a highly structured process of institutionalized entities like 'taxpayers', 'tax authorities', 'tax practitioners' up to 'tax lawmakers', individual tax behavior is embedded in and influenced by social structures norms and roles (see also Alm, Kirchler, & Muehlbacher, 2012; Alm, Kirchler, Muehlbacher, Gangl et al., 2012; Kirchler, Muehlbacher, Kastlunger, & Wahl, 2010).[3] It is to be expected that there exist certain role-models of taxpayers as well as of the other players in the game of taxation.

Fig. 1 represents the institutional infrastructure of the players and their (actual as well as potential) interactions (depicted by lines between the players).[4] For sake of readability, three kinds of lines are employed: bold lines represent direct (and legally structured) interactions, simple lines indicate actual and/or potential contacts and dashed lines signify indirect (actual or potential) influences. To start with, taxpayers may interact with each other by exchanging information about the behavior of tax authorities, by giving informal advice in tax matters, by cooperating in tax evasion (e.g., by working in the shadow economy) and in many other ways. Their connections are depicted by simple lines. In the same way interactions of taxpayers and tax practitioners are shown in Fig. 1 since taxpayers may consult the latter for filing tax returns or for professional advice in tax matters.

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[1] Note that the paper of Srinivasan was submitted earlier than the Allingham-Sandmo paper, but published later; see Hokamp (2012), p. 9, footnote 6.

[2] There exist different notions for persons who professionally consult and advise persons in tax matters: tax advisers, tax practitioners, tax preparers, tax consultants, tax accountants. In the following, 'tax practitioners' is used for these persons.

[3] A general sociological theory which fits well to capture the kind of social interactions and embededdness considered here is presented in Durlauf (2001); see also the "wider context", i.e., "the tax system as a whole and the environment in which it has to operate", James & Edwards, 2008, p. 35. For social interactions in economics see Manski (2000). Nerré (2008) suggested "tax culture" as an idea to include the "national tax-cultural diversity" in an "embeddedness approach" (Nerré, 2008, p. 153). Ho and Wong (2008) review literature on ethical attitudes and tax compliance. For major research on tax morale see Torgler (2002, 2007), Torgler and Schaltegger (2006), Alm and Torgler (2006, 2011), Frey and Torgler (2007), Demir, Macintyre, Schaffner, and Torgler (2008), Cummings, Martinez-Vazquez, McKee, and Torgler (2009), Alm and McClellan (2012), Pope and McKerchar (2011) and McKerchar, Bloomquist, and Pope (2013).

[4] Note that tax courts are not represented in Fig. 1 although their decisions may have a strong influence on the behavior of both taxpayers and tax authorities.