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Breaking the norms: When is evading inheritance taxes socially acceptable?

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ABSTRACT

Using the example of inheritance tax, we examine the relationship between the structure of the tax and the strength of the social tax compliance norm. Based on the assumption that deviation from a legal norm is the more accepted the less its underlying principles are jeopardized, we argue that violating the tax compliance norm is socially justifiable if revenue requirements as well as equity and efficiency tax principles are not infringed upon by the evasion. Building on the literature on tax evasion, optimal inheritance taxation, and family economics, we hypothesize that a large non-declared amount of transfer and a high liquidity of the transferred asset decrease the acceptability of inheritance tax evasion and that both a high degree of kinship and young age of the heir increase the acceptance of evasion. Utilizing an experimental design embedded in a survey on the acceptance of inheritance tax evasion conducted in Germany in 2012, we confirm these hypotheses empirically.

1. Introduction

Tax evasion receives much attention in economic research with a focus on what induces people to evade taxes and how to ensure compliance. Because the powers of the state to enforce compliance are limited, research stresses the role of third parties (e.g., Kleven et al., 2011), which may either report tax obligations or enforce social norms on compliant behavior. Although third parties reduce the incentives for evasion considerably, such a solution requires that actors accept and support the norm to pay taxes. In the presence of third party reporting, the conditions under which the general public accepts tax evasion more or less are of particular relevance. As detailed empirical analysis of perceptions of tax evasion is still lacking, our paper provides insights into the population's perceptions of tax evasion, focusing on inheritance tax as an example.

As a starting point, the paper considers a given legal norm stated by tax law that codifies that each taxpayer should fully contribute to the public good according to his or her liability. Any tax evasion is a deviation from this legal norm. Accordingly, authorities impose sanctions on the evader to foster tax compliance through deterrence.

However, since audits and punishment are costly, deterrence is practically limited and a sufficiently strict social tax compliance norm needs to complement the legal norm. Although legal norms originate from social norms, the change of social norms might lead to increasing incongruity between both types of norms. A weak social tax compliance norm will call the legitimacy of a given legal norm into question and, consequently, difficulties to ensure compliance arise. Hence, the degree of tax compliance depends - although not exclusively - on the acceptance of the legal norm and the acceptance of norm deviations, respectively.

In this paper, we analyze the conditions under which the German population considers deviations from a legal norm justified. More specifically, we investigate the acceptance of inheritance tax evasion. We argue that the legal norm's underlying principles

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influence the acceptance of deviations from it: the acceptance decreases under conditions that jeopardize these principles. Beyond the primary objective to finance government expenditure, principles of efficiency and equity guide tax systems. The public therefore accepts tax evasion that harms neither the revenue objective nor the efficiency and equity of the tax. Conversely, acceptance should decline if the tax raises less revenue, distorts taxpayers' behavior more heavily, or redistributes less to the poor. We test empirically the acceptance of deviant behavior, depending on the value of the evaded good, the type of transfer (monetary versus non-monetary), the relationship between the testator and heir, and personal characteristics of the heir (age). Providing a brief overview of the related literature, we combine insights from different strands of the literature and derive hypotheses on the acceptance of evasion behavior and its determinants. Subsequently, we test our hypotheses empirically with data from a German survey conducted in 2012.

Unlike most of the current literature, our focus is not on income taxation but inheritance taxation. Inheritance taxes are an especially interesting example for many reasons. First, bequests have become more relevant in recent years and will become more so in the near future as their share of national income increases (Piketty, 2011; Schinke, 2012; Atkinson, 2013; Ohlsson et al., 2013). Inheritance accounts for a substantial source of personal wealth; thus, inheritance taxation is potentially a desirable tool of redistribution. Second, emphasizing the relevance of redistributive justice concerns entailed in the key equity-efficiency trade-off of any tax, inheritance tax provides an especially interesting case, due to its redistributive nature. Third, empirical analysis of inheritance tax evasion per se and acceptance of inheritance evasion behavior is, to date, lacking.

Although, social scientists, policymakers, and the public heatedly debate inheritance taxes (for an overview on the controversy in the US, see Gale and Slemrod, 2001; Graetz and Shapiro, 2011), similar controversies do not exist for most other taxes, e.g., income taxes. This reveals that the acceptance of inheritance tax and its evasion are especially important in understanding compliance behavior and in deriving policy conclusions.

Only a few systematic studies of the acceptance of (inheritance) tax evasion behavior and its potential determinants exist (McGee, 2012, being an example). To help closing this research gap, this paper makes two major contributions: First, we propose potential determinants of different levels of acceptance of tax evasion. Second, we propose an experimental method to test different channels that shape attitudes towards tax evasion. Because we employ a factorial survey design, which allows respondents to evaluate the acceptability of tax evasion under varying contextual information in a randomized setting, we can identify causal effects of situational factors on respondents' judgments about the acceptability of tax evasion. The analysis demonstrates that a large value of the evaded good, high liquidity of assets and lack of kinship between a bequeather and heir decrease the acceptance of evasion, whereas tax evasion by younger recipients appears to be more acceptable. The results show that respondents accept the violation of a legal norm of full tax compliance in certain situations. Interestingly, a comparison with the parallel study of Gross et al. (2017) reveals that acceptance of tax evasion and proposed tax rates are negatively correlated. This suggests that the public considers tax evasion as an acceptable way to neutralize taxes that people perceive as too high.

Our paper has several general tax policy implications. First and foremost, to ensure a high level of tax compliance, any tax design needs to balance revenue requirements with efficiency and equity concerns that the general public holds. Second, the results of acceptance studies provide information on potential dimensions that reforms should (not) tackle. Compliance with legal norms depends not only on their deterrent ability but also on the acceptance of their underlying principles. A discrepancy between social norms and legal norms can arise and impairs the stability of the legal norm.

The paper is organized as follows. Section 2 provides a brief review of related literature. Section 3 derives hypotheses regarding situations in which deviations from the legal norm are justified. Section 4 describes the survey experiment, its methodological background, and the results, including robustness checks. Section 5 presents concluding remarks.

2. Literature review

There is a broad discussion of the main determinants of tax compliance behavior. Initiated by the work of Becker (1968) and Allingham and Sandmo (1972), the deterrence model of tax evasion has been prevalent in the economics literature for many years. Allingham and Sandmo (1972) stress in their seminal work that both pecuniary and non-pecuniary factors play an important role in explaining compliance behavior. However, non-pecuniary factors have long received less attention than monetary deterrence arguments. Since the work of Allingham and Sandmo, empirical results have repeatedly indicated that observed levels of compliance are often higher than predicted by the classical deterrence model (see, e.g., Alm et al., 1992). One shortcoming of these studies is that the perceived audit rate is assumed to be equal to the number of audits divided by the number of all tax filings. According to a large-scale field experiment by Kleven et al. (2011), possibilities of evasion partially explain the gap between theoretical predictions based on this oversimplified definition of the audit rate and empirical findings. These authors examined the difference between self-reported income and income subject to third-party reporting in Denmark, concluding that there is substantially less evasion under third-party reporting. Additional elements helpful in understanding tax compliance decisions are put forward in behavioral studies (see, e.g., Cialdini, 1989; Alm et al., 1993; Torgler, 2002). These studies show that other factors, such as norms (see, e.g., Wenzel, 2004; Traxler, 2010) or justice concerns (see, e.g., Wenzel, 2002; Alesina and Angeletos, 2005), are also important in explaining compliance behavior.

Over the last few decades, a vast empirical and theoretical literature has evolved that incorporates norms as an important determinant of tax compliance behavior. However, if we assume that such norms are not fully internalized but must be enforced by other actors within a population, questions arise regarding the conditions under which people perceive a given deviant behavior to be either justifiable or sufficiently severe to merit punishment.

Only a few studies examine the attitudes toward compliance and tax evasion, although norms, fairness considerations and social interactions are recognized to be factors in tax compliance behavior. Feld and Larsen (2012) and European Commission (2014)