Perceived tax evasion and the importance of trust

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A B S T R A C T

Using Swedish individual survey data, we analyze the perception of tax evasion in terms of ten different
taxes. We find large variation across taxes, highlighting the importance of studying different taxes sepa-
rateley rather than treating tax evasion as one common phenomenon. We focus on the importance of trust
in taxpayers and in politicians. Those who do not trust their fellow citizens are more likely to believe that
they are evading taxes, but distrust in politicians has an even greater effect, especially for redistributive
and fiscally motivated taxes. Hence, it is important for politicians to be perceived as trustworthy in order
to be able to collect taxes for maintaining the welfare state.

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1. Introduction

Maintaining a general welfare state requires quite large tax rev-
enues. In a non-totalitarian society, tax payment must, at least to
some extent, be voluntary and it is therefore important to make
people willing to pay the taxes they are obliged to pay. There is a
large body of literature on tax compliance that gives explanations
to what actually makes people willing to pay taxes.4 One impor-
tant determinant has shown to be the perception of what others
do: If people are convinced that their co-citizens are doing their
fair share, they are themselves more willing to contribute, while
perceived tax evasion (true or not) among others affects tax com-
pliance negatively.5 Hence, understanding perceived tax evasion is
important in order to prevent true tax evasion. This paper attempts
to do just that; we analyze factors that make people believe that
others evade various kinds of taxes. We use individual survey data
from Sweden – a country with a high general tax-level and with a
large public sector – and we specifically analyze the respondents’
perceived evasion of ten different taxes.6 An obvious advantage of
studying perceived rather than actual tax evasion by means of a
survey is of course that we can expect respondents to answer more
truthfully when they are not asked to reveal their own behavior
in this rather sensitive matter. We find trust both in taxpayers and
in politicians to be very important for perceived tax evasion in the
sense that (1) the more the respondents claim to trust other people
(i.e. taxpayers), the less they suspect them to cheat. However, for

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4 See Andreoni et al. (1998) for a thorough survey.

Torgler and Schneider (2005) who study Austria find a strong negative impact of
perceived tax evasion on tax morale as do Frey and Torgler (2006) using data from
30 European countries.

The taxes are municipal and state income taxes, payroll tax, corporate tax, real
estate tax, gift tax, wealth tax, alcohol tax, vehicle tax, and carbon dioxide tax on
fossil fuels.

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most taxes the effect of political distrust is even greater: (2) respondents who distrust the politicians in the Swedish parliament are about twice as likely to perceive evasion of payroll, corporate, real estate, gift, and wealth taxes to be common compared to those who do not distrust the politicians.

Trust is commonly considered to be important for the maintenance of social capital (Putnam, 1993, 2000) and for the general social and economic development in societies (Rothstein and Uslaner, 2005). For instance, generalized trust as defined by Yamagishi and Yamagishi (1994) roughly deals with to what degree one trusts that others do their share. Empirical findings also show that trust in the government, public officials, and in the legal system has a significant positive effect on tax morale (see e.g. Tyler, 1990; Scholz and Pinney, 1995; Scholz and Lubell, 1998; Torgler, 2003a,b, 2004), and a study by the Swedish Tax Agency (STA) (2005b) – STA is an autonomous public authority accountable to the Swedish Government – shows that the most common argument legitimizing tax evasion among Swedes is that those in leading positions in society trust that others do their share. Empirical findings also show for people's willingness to pay taxes (see e.g. Scholz and Lubell, 1998; Frey and Torgler, 2006), and as stated by Bordignon (1993), one can even regard it as unfair to comply if others do not. Hence, trust is likely to be an important determinant for actual as well as perceived tax evasion. A key finding in this paper is that political and generalized trust appear to play different roles for the perceived evasion of different types of taxes.

Previous research on tax evasion and compliance has mainly dealt with income taxes and to some extent with VAT.7 This, we argue, is probably a too simplified view. Taxes differ for example with respect to how technically easy they are to evade and how popular they are, and these factors can also be expected to affect the perceived evasion of different taxes. This is also what we find; both the perceived occurrence of tax evasion and its determinants differ among taxes. To our knowledge, this is the first tax-evasion study that looks at several kinds of taxes.

The Swedish taxes that we investigate in this paper differ in popularity, with the real estate and gift taxes being the most unpopular. Also, the tax base (e.g. carbon dioxide, alcohol, income, gifts) and motives (steering, fiscal, distributional) differ among these taxes, which may affect the perception of tax evasion. It turns out that more than 70% of the respondents think that gift and wealth tax evasion is common, while only 17% think that evasion of the vehicle tax and the carbon dioxide tax on gasoline and diesel is common.

The paper is organized as follows. In Section 2 we present some suggested determinants of tax evasion in general. Thereafter we present a formal model of tax evasion and our formulation of the hypotheses. Section 4 contains a presentation of the data including a description of the studied taxes, followed by a regression analysis in Section 5. Some concluding remarks in Section 6 end the paper.

3. Model and hypotheses

In a theoretical model, we try to incorporate the previously mentioned explanations of tax compliance. When modeling the agent’s problem in an Allingham-Sandmo fashion, we add a “social-taxpayer factor” to the utility function. We also include utility from the public sector itself, i.e. an explicit modeling of the perceived benefits of public expenditures (financed by taxes and administered by politicians and public officials). We assume that utility is strictly concave in consumption, implying that the individual is risk averse. We also assume that the individual receives two kinds of income, \( Y_A \) and \( Y_B \), both subject to taxation but possibly at different rates. The expected utility, \( E[U] \), is

\[
E[U] = (1 - p)U[Y_A - t_A Y_A + Y_B - t_B Y_B] + pU[Y_A - t_A Y_A + Y_B - t_B Y_B - f_a(Y_B - D_{Y_B}) - d_a(Y_A - D_{Y_A}) - d_B(Y_B - D_{Y_B})] + E[\theta],
\]

where \( Y_i \) is total gross income of type \( i \) and \( D_{Y_i} \) is declared income, which is taxed at the tax rate \( t_i \), \( i = A, B \). Income evaded is therefore \( Y_i - D_{Y_i} \geq 0 \). The subjective probability of auditing is \( p \), and in that case both kinds of income are audited.11 If the individual is caught, a fine proportional to the evaded amount has to be paid, \( f_i(Y_i - D_{Y_i}) \).

7 Related to value added tax there has been considerable work undertaken (Adams and Webley, 2001; Bergman and Nevares, 2006; Crossen, 1994; Webley et al., 2006).

8 See e.g. Scholz and Lubell (1998), Torgler (2003a,b), Davis et al. (2003), and Fortin et al. (2007).

9 Naturally, the model can be extended to a “many-tax” model. For reasons of presentation we choose to model only two taxes.

10 Allingham and Sandmo (1972) discuss what affects \( p \), and Sandmo (2005) extends this discussion. In this paper we do not analyze this probability per se.
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