

# Dynamic behaviour in tax evasion: An experimental approach

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## Abstract

This paper investigates, from an experimental perspective, tax payer behaviour, specifically focusing on three main topics related to tax evasion. First analysed are the effects of a repetitive dynamic choice process on subjects' attitude towards risk. Second, the effects of psychological moral constraints on taxpayer behaviour are examined. Finally the effect of context upon behaviour is analysed. The results from eight experiments confirm the importance of the psychological factors in determining taxpayer behaviour and show the complex dynamics that agents activate in order to cope with risk.

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## 1. Preamble

The core of this paper consists of the results obtained from a programme of experiments conducted at the Computable and Experimental Economics Laboratory of the University of Trento (CEEL), the intention being to analyse the influences exerted by psychological factors on tax evasion.

The psychological dimension of tax evasion has been analysed from many perspectives, starting as early as the 1960s. The first psychological aspect of tax evasion investigated in the literature

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is the effect played by the degree of fairness of the fiscal system. Starting from empirical observations, many authors (e.g. Adams, 1965; Thibaut et al., 1974) reached the conclusion that the degree of compliance with the fiscal rules is influenced by the perceived fairness of the rules themselves. More precisely, this psychological device of self-restraint seemed strongly correlated with the nature of the exchange relationships between the agents. In the specific case of tax evasion the exchange is between the tax-payer and the state, and therefore the degree of effectiveness of the mechanism of individual self-restraint fails when the tax-system becomes too oppressive, (i.e., when it is perceived as unfair).

Among the most interesting experiments carried out on fiscal fairness one can mention Spicer and Lee Becker (1980).<sup>1</sup> The purpose of their experiment was to examine the relationship between the perception of inequity in the tax system and tax evasion. The aim was to verify if the amount of taxes evaded increases among victims of inequity and decreases among its beneficiaries, the intention being to clarify whether the perception of inequity effectively increases evasion or whether it is instead only one way to rationalise illegal behaviour.

The game consisted of a tax game lasting 10 'monthly' periods in which the subjects were confronted by hypothetical decisions on tax evasion. Participating in the experiment were 57 students from the University of Colorado, 21 males and 36 females, aged between 21 and 29.

At the beginning of the game the participants were told that:

- each player would receive the same wage at the beginning of every month;
- each of them had to decide how much of his/her wage to declare and then pay the relative tax;
- in each period, randomly selected participants would be audited and if the tax paid was less than the sum due, fines equal to 15 times the amount of tax evaded would be inflicted. The participants were informed that there was 1 chance in 15 of being audited, and that audits were made only on taxes evaded in that period.

The objective of each participant was to maximize his/her net income (gross income – taxes paid – fines), on which basis a money reward was distributed at the end of the game. The subjects were also given additional false information on average tax rates in order to induce some of them to feel that they were being treated unfairly. All the subjects were informed that their tax rate was 40%. Then, 19 of them were told that the average rate was 65%, while a further 19 were told that the average rate was 15%. The remaining 19 subjects were told the truth (i.e., that all participants paid at the same rate). When the 10 periods had passed, a questionnaire was administered to the subjects in order to ascertain their perception of, and attitude towards, tax evasion.

The results indicate that on average, the subjects evaded 23.13% of the taxes payable, and that the percentage of evasion was higher among those who had been told that they had to pay at a higher-than-average rate, and lower among those informed that they would be paying at a lower-than-average rate.

Other authors have investigated different psychological mechanisms. In particular, Baldry (1985, 1986) tried to verify the discouraging effects produced when the tax declarations are made public and when the experimental design takes the form of a real world situation. Baldry's main results are that when tax declarations are kept private, evasion increases, while it decreases when tax declarations are public and that subjects' behaviour changes if they are asked to take decisions in a context which resembles a gambling game as opposed to a real world situation.

<sup>1</sup> See also Becker (1968) and Becker et al. (1987). A "classic" reference on the tax evasion topic is Cowell (1990).

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