

# SHADOW ECONOMY

## TAX EVASION AND DEATH SALIENCE

Guest lecture

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## OUTLINE

- General thoughts about tax evasion
- Why are people relatively tolerant towards tax evasion?
- How can perception be changed?
- Study: Experiment, based on Terror-Management Theory
- Conclusion
- Implications

## SHADOW ECONOMY AND TAX EVASION

- Shadow economy including tax evasion has been a growing problem in Western societies over the last decade (Enste & Schneider, 2005).

Relative size of shadow economy around the world in 2000 (percent of GNP; Schneider & Klinglmair, 2004)

<u>Continent</u>	<u>Shadow Economy (%)</u>	
Africa	41	
Asia	26	<b>Austria 10</b>
South America	41	<b>Italy 27</b>
OECD Countries	17	<b>Germany 16</b>
European Countries	18	<b>GB 13</b>
		<b>Netherlands 13</b>
		<b>Switzerland 9</b>
		<b>Australia 14</b>
		<b>Japan 11</b>
		<b>USA 9</b>

## TAX EVASION AS A SPECIFIC CASE OF SHADOW ECONOMY

**Tax evasion** “...is *illegal*, as it involves deliberately breaking the law in order to reduce one’s taxes.  
(Webley, 2004)

**Tax avoidance** ”In contrast to tax evasion it refers to *legal* measures to reduce tax liability. (James & Alley, 2002, p. 31)

**Tax flight** “storing money at tax exiles” (Kirchler, 2007).



# TAX SYSTEM AS SOCIAL DILEMMA (DAWES, 1980)



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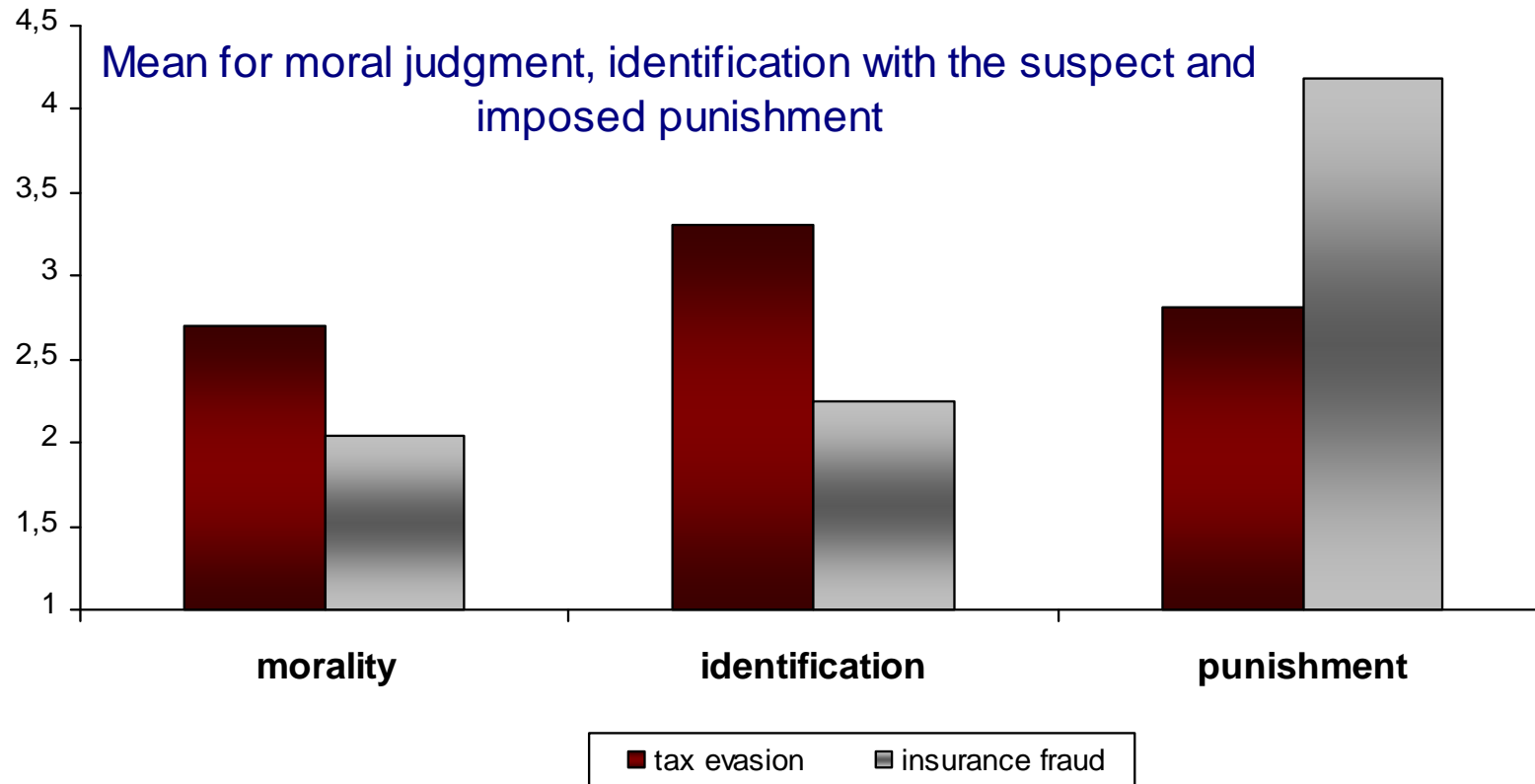
- Tax evasion disadvantages honest tax payers, due to an unfair distribution of tax load and decrease of the common good.
- Paradoxon: Tax evasion is often considered as a petty crime.



Henry K. is self-employed. He has built his own little software company, which initially cost him a lot of courage and stamina. Because he has to support a family, he faces the additional pressure of earning enough money every day. After five years he has succeeded in building a sufficient customer base, allowing him to employ two colleagues. However, there is never enough money for big vacation trips or for a new car. Besides, refurbishing the rooms in his office and purchasing new computer equipment have become urgently necessary. He thinks about how to get to the necessary money because his company will not earn more money in the coming years.

- Henry K. receives a large order. This deal would generate enough money to allow him completely refurbishing his office. If he were to declare this income to the tax office, he would be placed into a new tax bracket and only half of the money would remain. He decides not to report the sum of **38.000 Euros**. The evasion of taxes is not discovered.
- One night, he secures the articles of value in a secure location and floods his office rooms. He reports a water damage based on a burst pipe to the insurance company. The damage is estimated at **19.000 Euros**. The insurance pays and the insurance fraud is not discovered.
- How do you evaluate Henry`s behavior from a moral perspective?  
(1 = “very moral” to 6 = “very immoral”)
- To which extent do you identify with Henry`s behavior on a scale from 1 to 6? (1 = “very strongly” 6 = “not at all”?)
- Which punishment would you impose on a scale from 1 to 10? (on a scale from 1= “no penalty” to 10 = “highest penalty”?)

# Kirchler & Pitters (2007)



N=125 participants (78% female, 22% male).

## TAX EVASION, A PETTY CRIME?

- Fraud against society is seen more leniently than fraud against insurance.
- Results are in line with other findings, e.g. tax evasion was seen more leniently than stealing a car or drunk driving (Song & Yabrough, 1978).
- E.g. 53% of a representative German survey considered tax evaders as gentlemen, 42% would not even fine them (Schmölders, 1964).
- Typical taxpayers were considered as less intelligent and less positive than tax evaders (Kirchler, 1998).

## REASONS FOR TOLERANCE TOWARDS TAX EVASION

- Taxes are perceived as unfair, justice is the most frequently mentioned concern when asking people about the tax system (Braithwaite, 2003; Kirchler, 2007).
- According to Prospect Theory (Kahneman & Tversky, 1979; 2000) insurance fraud represents loss, tax evasion lack of contribution, framing influences perception.

## HOW TO CHANGE EVALUATION OF TAX EVASION?

- Tax authorities should communicate social norms on a collective level referring to the common good of the state, arguing that this might enhance a feeling of civic duty as societal norm (Taylor, 2003; Wenzel; 2004).
- Tax morale can be considered as coping strategy to the “annual hassle“ of tax demands (Braithwaite, 2007).
- People don` t have clear ideas about taxes and are easily influenced by situational cues (Kirchler, 2007). “Framing“ can have a decisive impact on perception of taxes and choice of punishment for tax evasion (Seidl & Traub, 2002).
- Thus, perception of tax evasion is influenced more easily than perception of insurance fraud.
- Is perception of tax evasion influenced by death salience?

## THEORETICAL BACKGROUND

Terror-Management-Theory (TMT)

(Solomon, Greenberg & Pyszczynski, 1991; 1997)

They start with two basic questions:

1. Why do people strive for self-esteem?
2. Why are human beings bothered by relevant others who deviate from their opinion?



### Theoretical assumptions

(based on approach of Ernest Becker, 1973 and social psychological theories on self-esteem, (Scheff, 1990))

Consciousness of the own mortality causes fear (terror).

This fear is managed by two buffers:

1. belief in a cultural worldview (that offers order, stability, meaning and permanence).
2. Belief that a person is a significant contributor to this meaningful reality.



## THEORETICAL BACKGROUND

- If people are reminded of their personal mortality, they tend to defend their cultural worldview and devalue deviant opinions.
- Theory has been the basis of more than 300 studies in several countries (Solomon et al., 2004) and applied to different subjects such as religion, political preferences, legal decision-making, consumer behavior.
- It has also been applied to explain the effect of terrorism on human behavior.
- E.g. after 9/11, purchases of patriotic flags and tattoos and Osama bin Laden toilet paper increased, whereas economy in general had been weakened (Pyszczynski, Solomon & Greenberg, 2003).

# ASSUMPTIONS

Regarding the tax system as a cultural system representing norms and values, people should defend this system when being reminded of death.

## **Hypotheses**

- Attitudes towards tax evasion are generally more lenient than attitudes towards insurance fraud
- Reminding people of their personal mortality affects attitudes towards tax evasion and attitudes towards insurance fraud in the direction of perceiving these behaviors as more punishable. Attitudes towards tax evasion are influenced more strongly than towards insurance fraud.

# METHOD

## Participants

- $N = 172$  participants, recruited at the University of Vienna (36 % male, 64 % female)
- Age  $M = 25.99$  ( $SD = 6.88$ )
- Nationality (90 % Austrian, 10 % German, others were excluded from Analysis).

## Design

- 2 (experimental/control condition) X 2 (tax evasion/insurance fraud) design
- Participants were informed that the first task aimed at collecting stimulus material, whereas the second would ask them about the judgment of a case study.



# METHOD

## Design

	<u>priming</u>	<u>death</u>	<u>nature</u>
<u>scenario</u>			
Tax evasion		<i>N</i> = 47	<i>N</i> = 52
Insurance fraud		<i>N</i> = 36	<i>N</i> = 37

## Dependent Variable

### Penalty

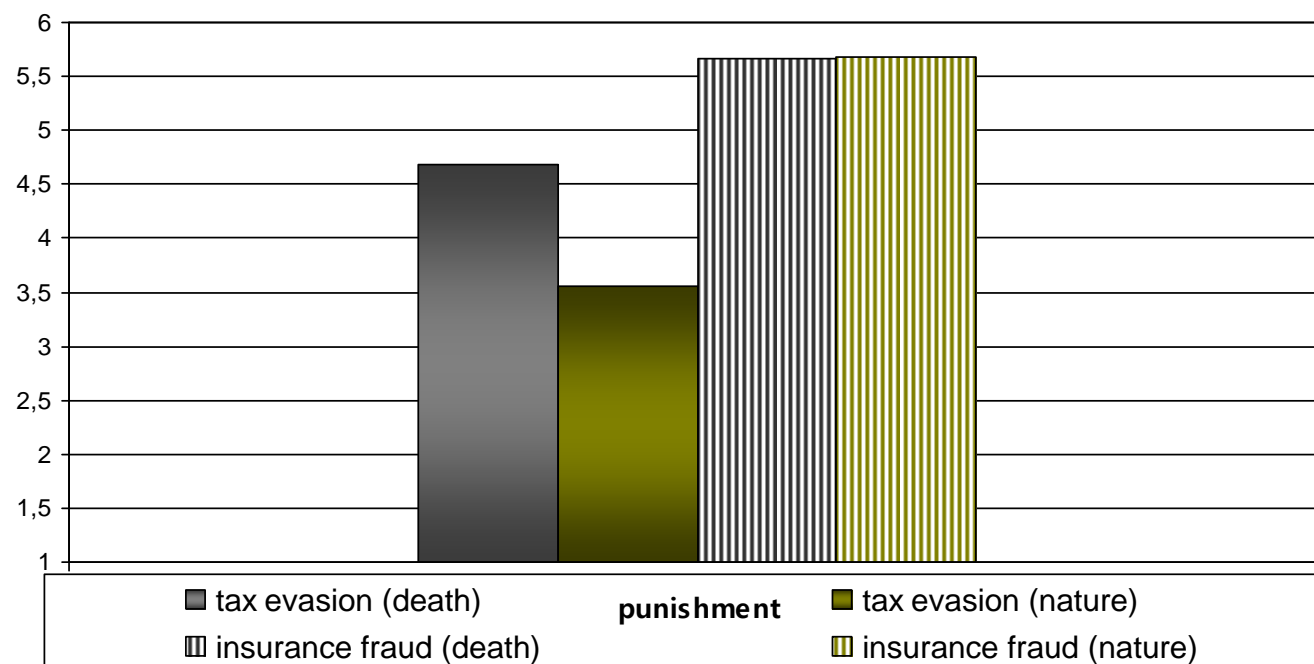
(from 1="no penalty" to 10="maximum penalty")

## Moderator Variables

- **Moral judgment of crime** (from 1="very immoral" to 6="very moral")
- **Identification with the suspect** (from 1="not at all" to 6="very strongly")

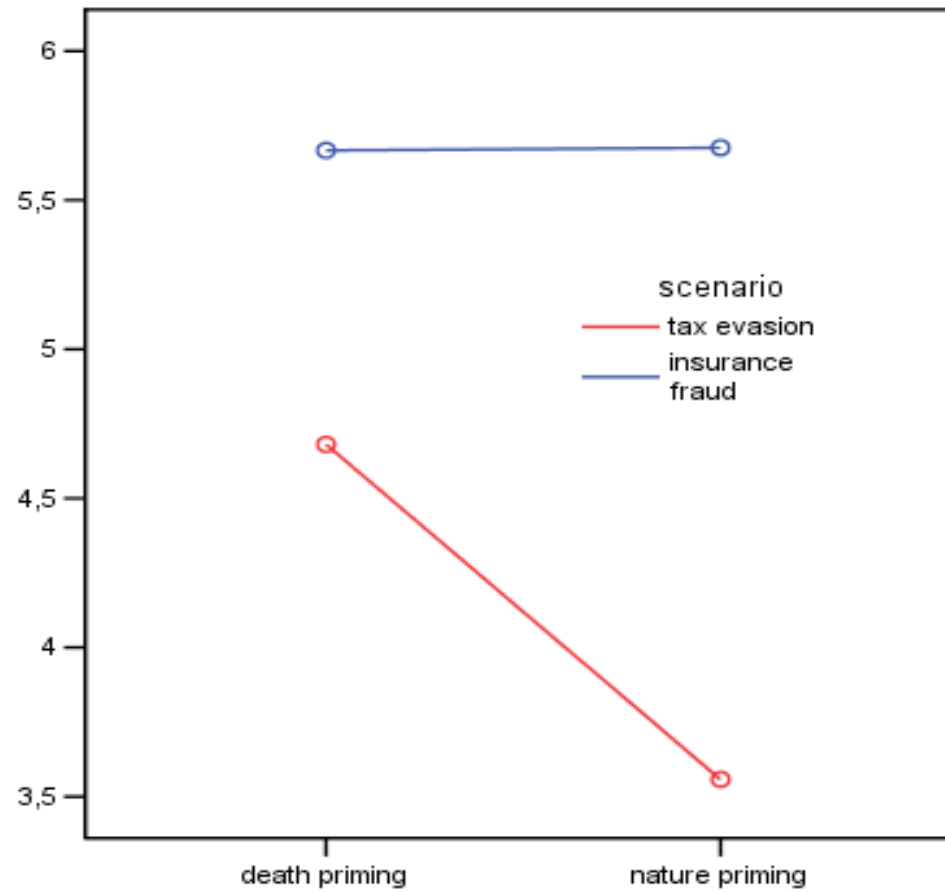
# RESULTS

Mean of “priming death” versus “priming nature” in the conditions  
“tax evasion” versus “insurance fraud”\*



\*penalty on a scale 1=“no penalty” to 10=“maximum penalty”.

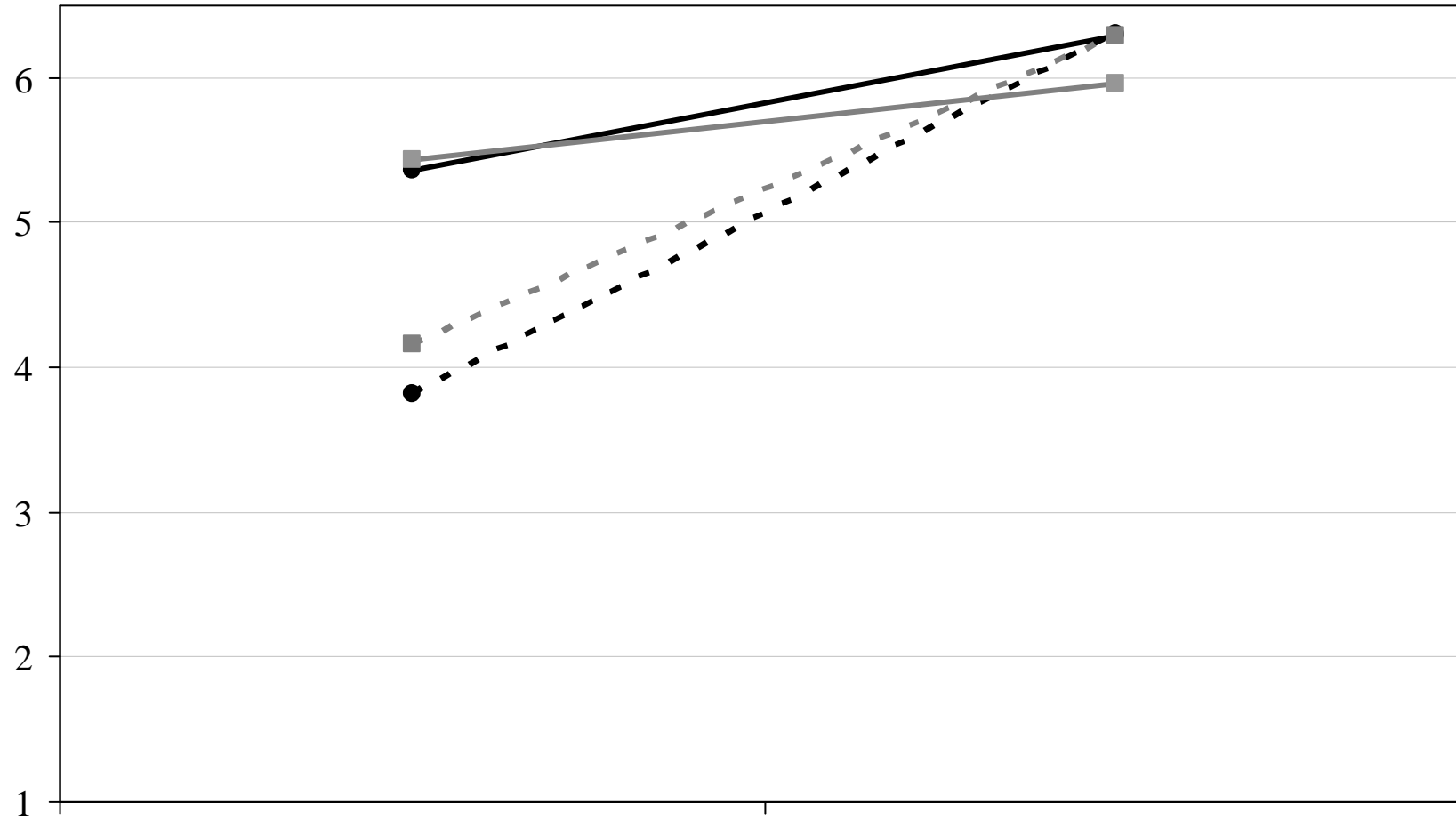
# RESULTS



Interaction effect between priming and scenario on penalty, significant at 10 % level ( $F(1, 1168) = 3.35, p < .07$ ).

# RESULTS

Penalty

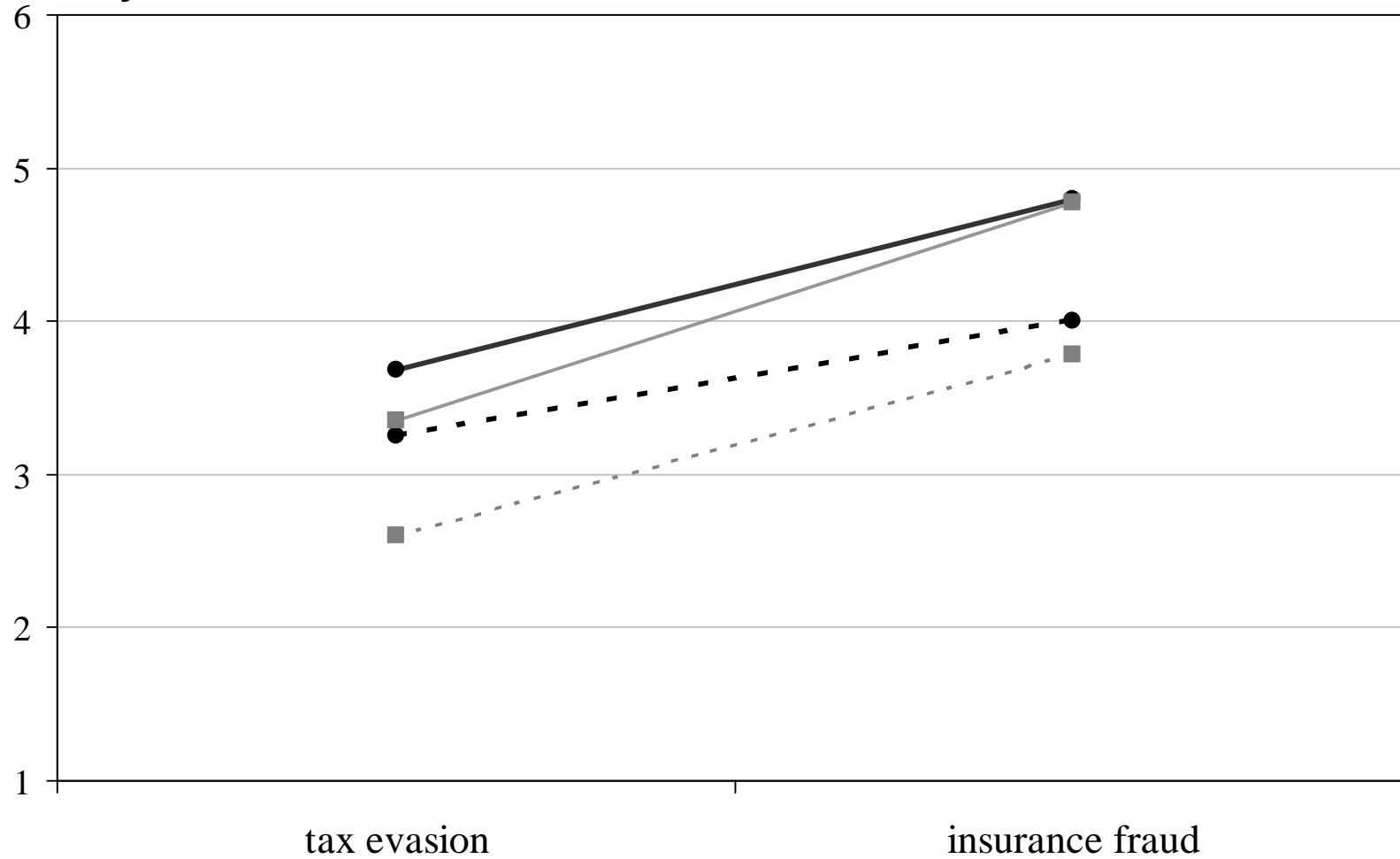


Significant interaction  $p < .05$



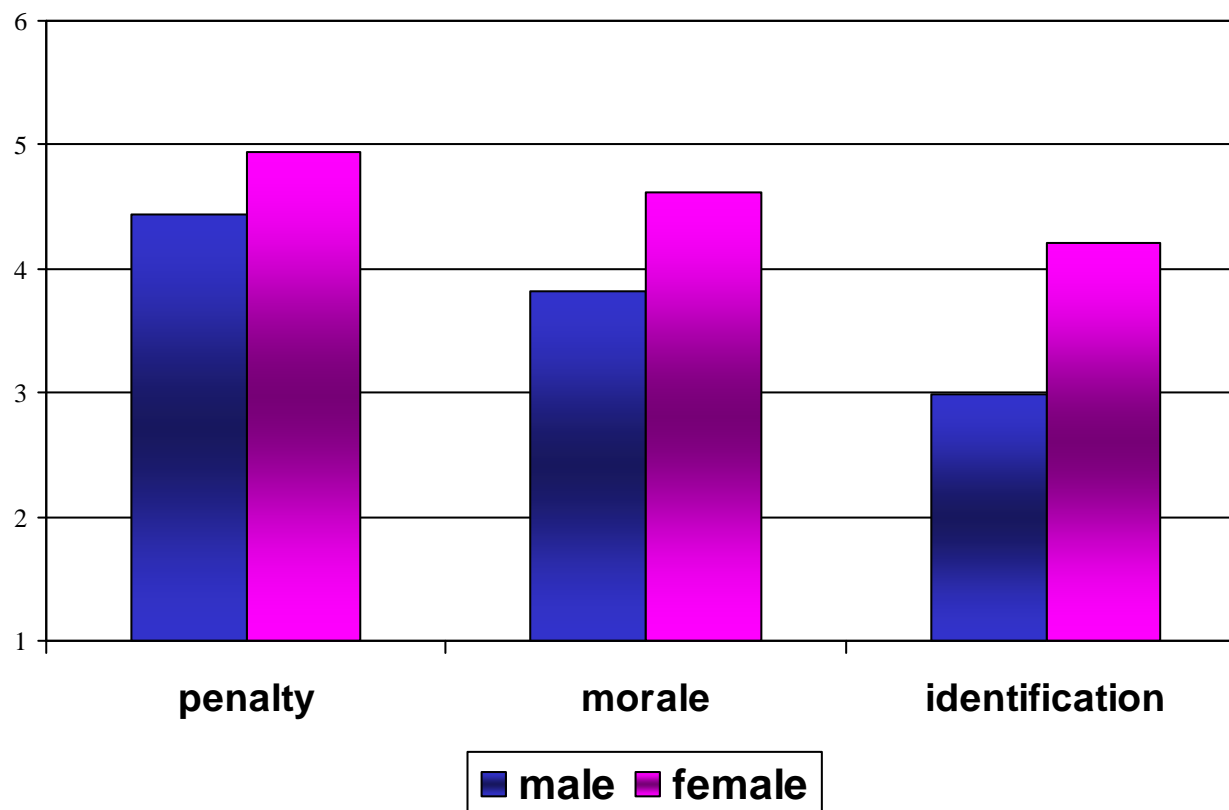
# RESULTS

Penalty



Non-significant interaction  $p > .05$

## FURTHER ANALYSIS



**Females** judged the crimes as **less moral** than males  $t(170) = 4.12, p < .01, d = .64$  and **identified less** with the suspect  $t(170) = 4.55, p < .01, d = .73.$ , whereas penalty did not differ  $t(170) = -1.43, p > .05$ .

# CONCLUSION

- Tax evasion is perceived as more punishable than insurance fraud (in line with previous findings)
- Death Salience influenced participants` judgments of the appropriate penalty for tax evasion (in line with Terror-Management Theory)
- Death Salience did not affect the evaluation of insurance fraud.

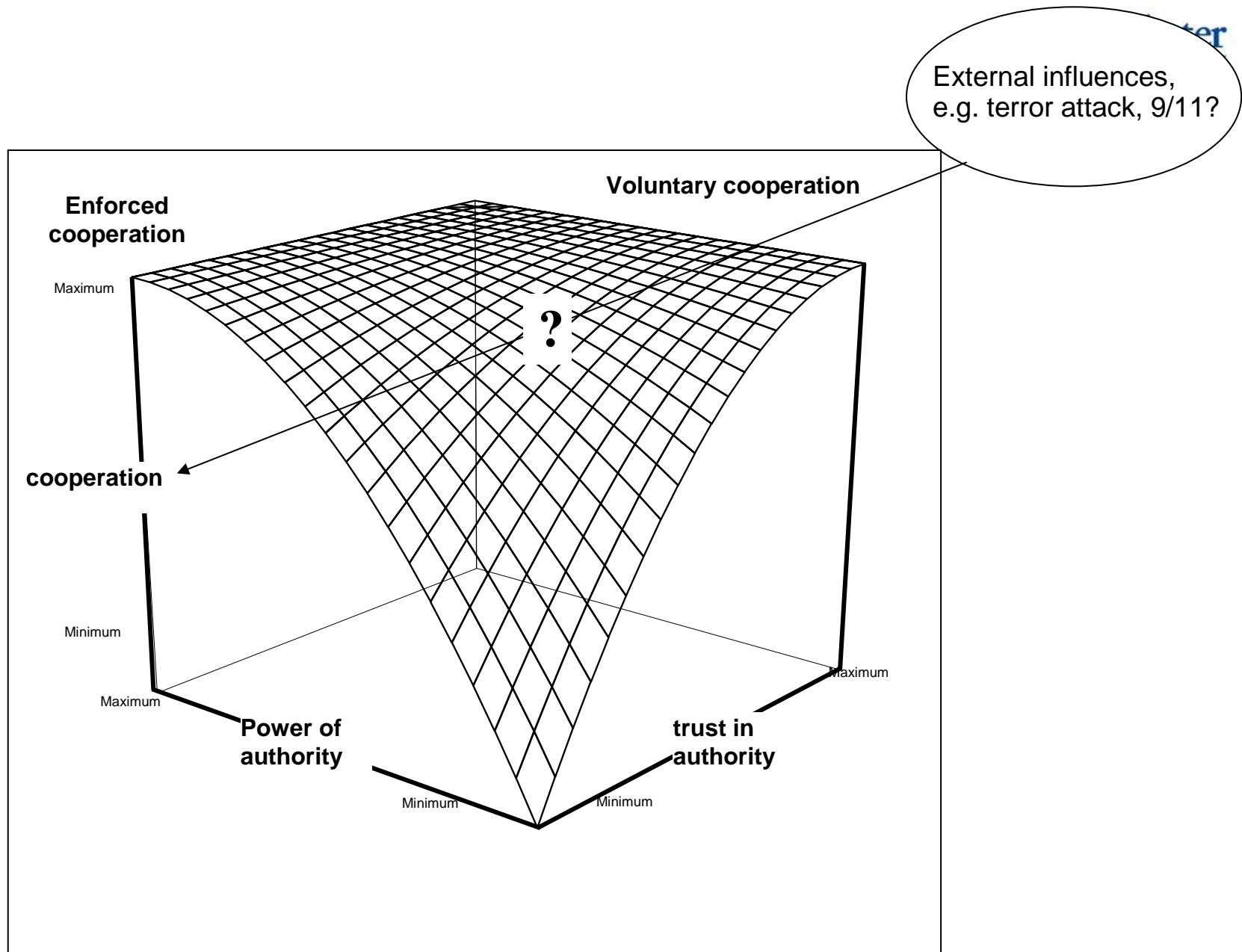
## DISCUSSION

### WHY DID PRIMING ONLY AFFECT TAX EVASION?

- People are less familiar with the tax system than with the insurance fraud system, so they are more easily influenced by irrational factors.
- Tax system is more likely to represent a system of value than insurance system.

## PRACTICAL IMPLICATIONS

- Does death salience on a macro level (e.g. September, 11) influence the personal value system of persons not directly affected by terror?
- Comparison of representative Eurobarometer data before and after 9/11 terrorist attacks reveals that terrorism became greatest fear and trust in state institutions as police and army increased significantly (European Commission, 2001)
- Could external factors influence the perception of the tax system?



Slippery-Slope Modell (Kirchler, 2007)

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Thank you very much!