

TO PAY OR NOT TO PAY: ENTREPRENEURS' ATTITUDES TOWARDS TAX EVASION

Tomasz M. Mickiewicz

Aston Business School, Aston University, UK

Anna Rebmann

University College London, UK

Arnis Sauka

Stockholm School of Economics in Riga and Ventspils University College, Latvia

CRCE, ZAPLATA, 25 SEPTEMBER 2013

PAYING OR NOT PAYING TAXES

Tax evasion: why important

- Entrepreneurial effort allocated to unproductive activities (Baumol, 1990)
- Erosion of tax base
- Increases informal economy
- Vicious circle of higher taxes and increased avoidance (e.g. Greece)

BUT

- individual & firm-level incentives for evasion exist

NEXT TO IMPOSSIBLE TO MEASURE DIRECTLY THEREFORE WE FOCUS ON:

Tax morale

DEFINITION:

A moral obligation/intrinsic motivation to pay taxes (Torgler & Schneider, 2009)

An ethical belief about tax evasion

MEASURE

Is it justifiable to cheat on tax if one has the chance?

Always justifiable - Never justifiable

(World Values Survey)

MODEL

Beliefs about punishment for evasion

likelihood of being caught
severity of punishment

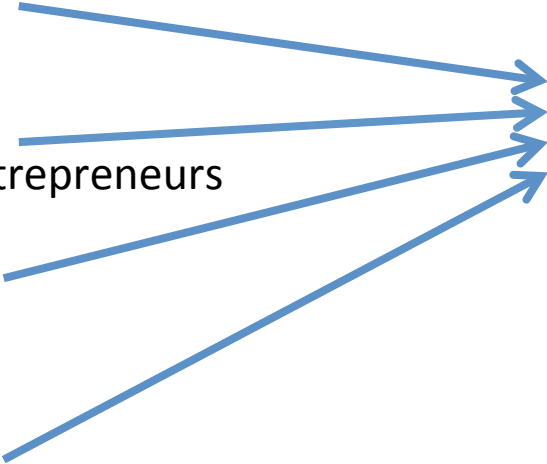
Perceived social norms

Tax avoidance by other entrepreneurs

Institutional trust

trust in government
trust in tax authority

Community belonging



tax morale

CONTROLS		
Firm performance: either last three years or last two years	Firm attributes: number of employees sector ownership based in capital city	Individual attributes: gender age education ethnicity

DATA

- Latvian survey data, collected winter 2010
- 279 owners-managers of SMEs
- Random sample drawn from the company register
 - Median size firm = 4 employees
 - Mean size firm = 15 employees
 - Range : 1 to 300 employees

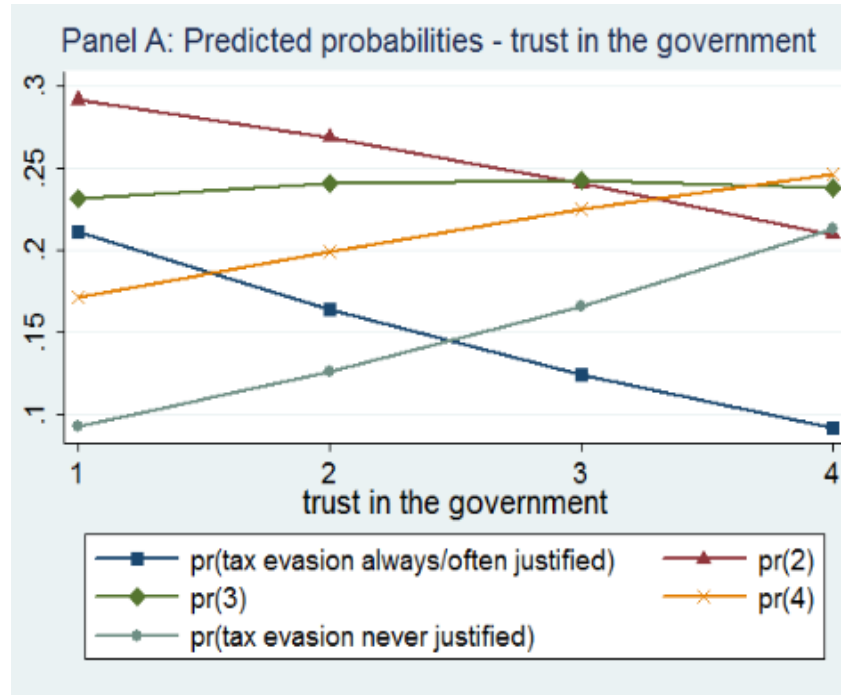
Ordered probit regression; dependent variable tax morale

	1	2	3	4	5	6	7	8	9
Trust in government	0.16*	0.18*	0.09	0.13	0.12	0.08	0.16+	0.15	0.12
	(-0.08)	(-0.08)	(-0.07)	(-0.08)	(-0.08)	(-0.08)	(-0.09)	(-0.09)	(-0.08)
Trust in tax administration	0.20*	0.20*	0.23**	0.21*	0.23*	0.24*	0.27*	0.28*	0.27*
	(-0.10)	(-0.10)	(-0.09)	(-0.10)	(-0.10)	(-0.10)	(-0.12)	(-0.13)	(-0.11)
Community belonging	0.29**	0.29**	0.31**	0.23*	0.21+	0.24*	0.18	0.16	0.18
	(-0.10)	(-0.11)	(-0.10)	(-0.11)	(-0.11)	(-0.11)	(-0.12)	(-0.12)	(-0.12)
Perceived underreporting	-0.14	-0.19*	-0.18*	-0.20+	-0.24**	-0.23*	-0.17	-0.18+	-0.19+
	(-0.09)	(-0.08)	(-0.09)	(-0.11)	(-0.09)	(-0.10)	(-0.11)	(-0.10)	(-0.11)
Likelihood caught	0.09		0.13	0.13		0.12	0.05		0.07
	(-0.09)		(-0.08)	(-0.10)		(-0.09)	(-0.11)		(-0.10)
Severity of punishment	0.14+	0.15+		0.13	0.14		0.18+	0.19*	
	(-0.08)	(-0.08)		(-0.09)	(-0.08)		(-0.10)	(-0.10)	
Performance 2009-2010				-0.04	-0.06	-0.01			
				(-0.09)	(-0.09)	(-0.09)			
Performance 2007-2010							-0.16	-0.18+	-0.11
							(-0.11)	(-0.10)	(-0.11)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	212	217	233	181	183	196	156	158	166

Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05, + p<0.10

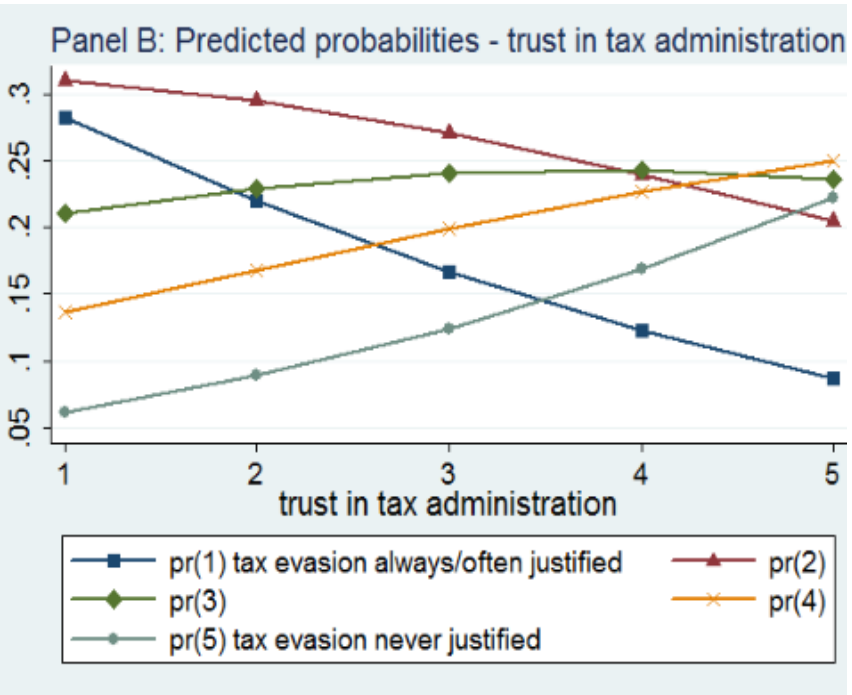
TRUST IN INSTITUTIONS

Trust in Government



- positively related to tax morale
- sometimes significant
- sensitive to model & sample size

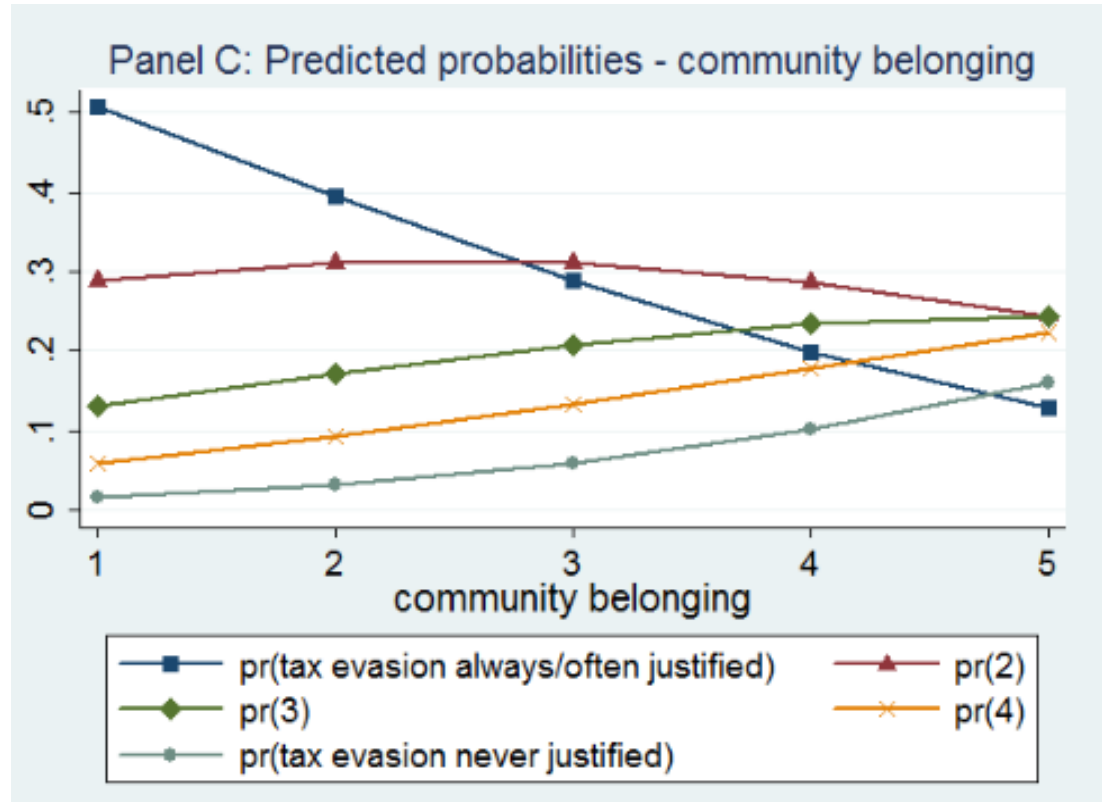
Trust in Tax Authorities



- positively related to tax morale
- significant across all specifications

COMMUNITY BELONGING

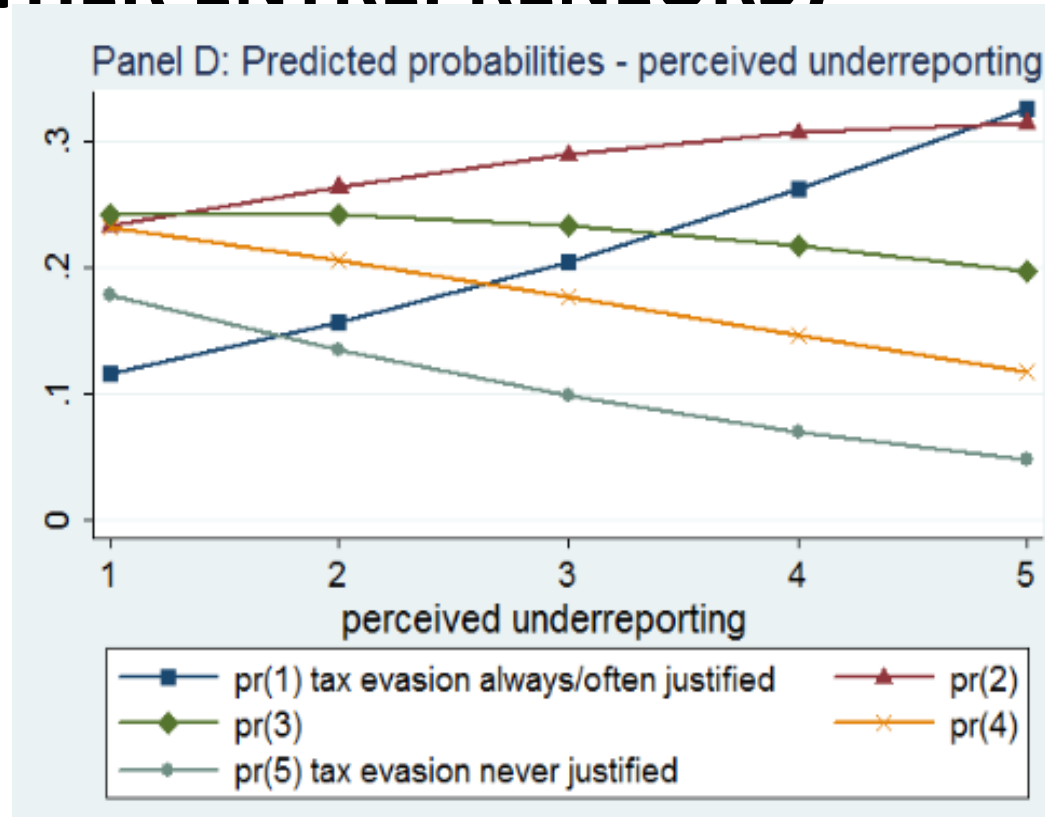
- positively related to tax morale
- significant across most models, except when small sample size



Identification with the polity & wider community may increase tax morale even when owner-managers may be critical of institutions and perceive others evading

PERCEIVED SOCIAL NORMS (OBSERVED BEHAVIOUR OF OTHER ENTREPRENEURS)

- Observing other cheating negatively related to own tax morale
- significant in most models, yet some problems with multicollinearity



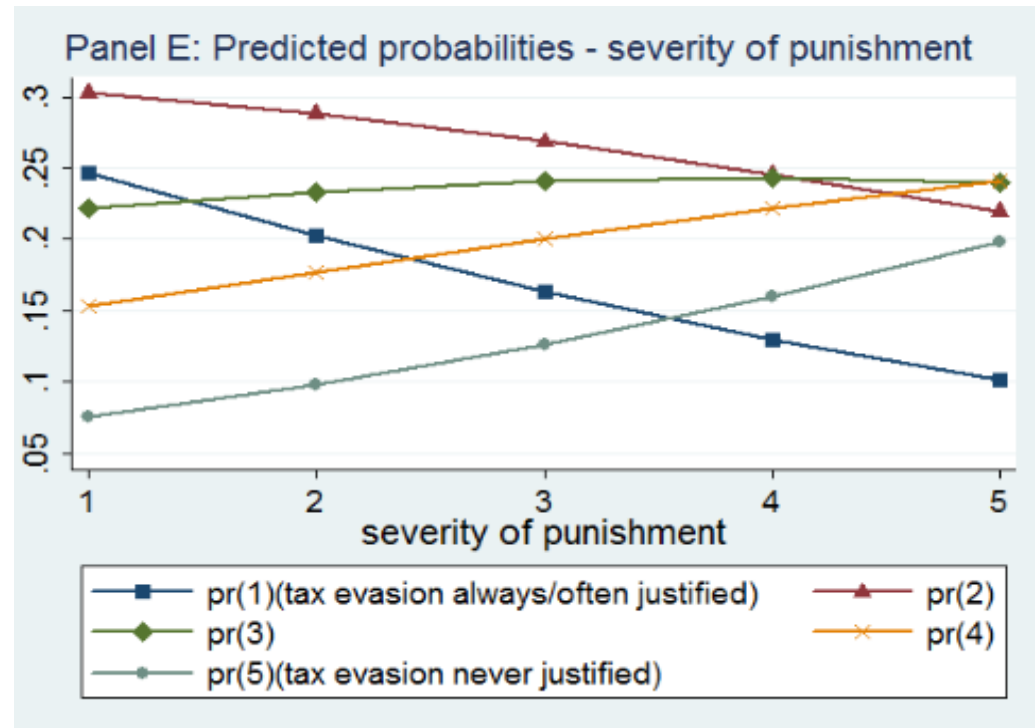
Suggests contagion effects from others evading taxes are likely

BELIEFS ABOUT PUNISHMENT

- Likelihood of being caught
– insignificant

YET

- Severity of punishment
– positively related to tax morale
– significant



Results consistent with:

- risk-avoidance
- ego-centric / self-serving bias

CONCLUSIONS

1. **Shadow economy is detrimental to entrepreneurship and therefore understanding which factors drive tax morale is critical.** Moreover, in is in the business context that questions about the tax morale should be asked.
2. **Advantages of combining lenses of economic and social analyses with the focus on entrepreneur.** It has been long recognised that institutions affect behaviour and economic outcomes, yet only with the focus on entrepreneur, we can understand more directly the mechanism via which the institutional contexts affect first cognition, next values and attitudes and finally behaviour. Thus, we demonstrate the effectiveness of combining institutional analysis with social psychology. This offers more general lessons for wider entrepreneurship research.
3. Results consistent with a **self-serving/ego-centric bias** and standard **risk avoidance**.
4. **Institutional trust** matters and so does **sense of belonging to the polity**.
5. Poor and corrupt administration may lead to a **vicious circle of non-compliance**. **Contagion effects** are likely, as entrepreneurs are affected by the behaviour of their peers. Moreover, **informal behaviour becomes embedded** and difficult to change.