

TACKLING TAX EVASION: Voluntary disclosure programmes boost tax revenues despite creating stronger incentives to evade

Offering tax evaders the opportunity to come clean voluntarily with reduced penalties is the best way to maximise tax revenues – even though it increases tax evasion. That is the conclusion of research by **Dominika Langenmayr**, to be presented at the annual congress of the European Economic Association in Mannheim in August 2015.

Her study finds that voluntary disclosure programmes lead to an increase in evasion because individuals know they are unlikely to be caught if they evade taxes and the penalty is small if they decide to come clean later. On the other hand, tax collectors report that voluntary disclosure decreases administration costs for collecting taxes by up to 90%.

The research finds that voluntary disclosure increases evasion:

- It is lenient: governments in almost all OECD countries offer voluntary disclosure programmes, under which people not yet under investigation for tax evasion are treated leniently when they declare foreign assets.
- Evaders disclose only when they have to: German whistleblower evidence from 2010 implies that tax evaders come clean only after they think it is more likely that they will be detected.
- Voluntary disclosure encourages rule-breaking: an empirical study of US data from 2009 showed that individuals significantly increased their offshore deposits after the introduction of the voluntary disclosure programme.

But voluntary disclosure also maximises tax revenues:

- It saves time and money for the tax office: a disclosure includes all information necessary to assess taxes at a lower cost than the government investigation.
- This saving may maximise net revenue: German tax offices quantified the reduction in work time as 30% to 90%, with two thirds citing a decrease in work time above 80%.

The author concludes that when there is a higher probability of detection, asking evaders to come clean voluntarily can increase tax revenues without overburdening the tax administration.

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When tax evaders come clean voluntarily, many governments offer lower penalties. Such voluntary disclosure programmes promise to increase tax revenues. But one might fear that lenient treatment of evaders encourages tax evasion – and indeed, as Dominika Langenmayr shows in her study presented at the Royal Economic Society's 2015 annual conference, this is the case. Nevertheless, offering voluntary disclosure can be beneficial for governments, as it saves administrative costs related to assessing the taxes of evaders.

To encourage tax evaders to come forward, governments in almost all OECD countries offer 'voluntary disclosure' programmes. The UK, for example, offers a general voluntary disclosure programme and additional special programmes such as the

Liechtenstein disclosure facility. When individuals not yet under investigation for tax evasion come forward and declare all foreign asset holdings, they are treated leniently: all income is taxed retroactively, but only a low fine applies.

Voluntary disclosure increases incentives to evade taxes...

Dominika Langenmayr's research shows that such programmes increase the incentives to evade taxes. To understand why, note that many tax evaders come clean only after they perceive an increase in the probability that they will be detected. This can be the case, for example, because the government acquires whistleblower data from a tax haven bank, as Germany did in early 2010. Figure 1 below shows that the number of voluntary disclosures shot up during that period.

These changes in detection probabilities explain why voluntary disclosure programmes increase tax evasion. When the detection probability remains low, the individual does not react. When the detection probability increases, however, voluntary disclosure offers the option to come clean at a relatively low cost.

Thus, the individual evades taxes as if the detection probability was low for sure, and we know that tax evasion is more attractive when the detection probability is lower. Without the option of voluntary disclosure, everybody would take the potential increase in the detection probability into account and would thus be less likely to evade taxes.

Langenmayr also tests this prediction empirically, using the introduction of a voluntary disclosure programme in the United States in 2009. Comparing the deposits of US residents in offshore banking centres often used for tax evasion with those from control countries, she finds that US residents significantly increased their offshore deposits (relative to the control group) after the introduction of the voluntary disclosure programme in 2009.

... but also increases tax revenues net of administrative costs

Nevertheless, almost all OECD countries have a voluntary disclosure programme. Dominika Langenmayr shows that this is because it allows the tax authorities to save on administrative costs. Tax evaders themselves, who know where their money was hidden, can prepare a voluntary disclosure (which, like a tax return, needs to include all information necessary to assess taxes) at a lower cost than the government could assess the evaded tax.

Langenmayr confirms this in a survey of German tax authorities. A strong majority of German tax offices state that administrative costs are significantly lower after a voluntary disclosure. When asked to quantify by how much working time decreases, the answers range from 30% to 90%, with two thirds citing a decrease in work time above 80%.

The topic of voluntary disclosures is especially relevant today, as the detection probability for tax evasion has gone up (for example, due to whistle-blowers or better information exchange with tax havens). In this environment, a voluntary disclosure programme is attractive, as it can increase tax revenues without overburdening the tax administration.

When governments expect further increases in the detection probability, Langenmayr's results imply that they should increase the fines after a voluntary disclosure. Despite its negative effect on tax evasion, it is a good idea to offer voluntary disclosure – at least as long as the main objective is to maximise tax revenues net of administrative cost.

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Figure 1: Voluntary Disclosures per Quarter in Germany

