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## An experiment on intertemporal choice and tax evasion

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When studying tax compliance behavior, laboratory experiments are one of the preferred research methods. In tax experiments, participants are typically informed if they are audited or not immediately after their compliance decision. In the real world, however, the time lag between the compliance decision and a probable tax audit can amount several years. This means that income concealed from tax authorities may be consumed today, but the risk of paying a fine in case of an audit is postponed into the future. On one hand, a fine that might be imposed on a taxpayer one day in the future reduces the costs of tax evasion and might seem less threatening. In this case, tax evasion would be more tempting. On the other hand, taxpayers might prefer to take higher costs now in order to avoid the dread deriving from possible negative events in the future. They might avoid such negative feelings by filing honest tax returns.

We conducted a laboratory experiment in which participants earned real income and had to pay taxes. Overall, 52 students were randomly assigned to one of two experimental conditions. In the first part of the experiment, all participants had to solve a task and were endowed with a certain amount of money. After earning their income, participants were informed that they had to pay taxes and will be audited and fined in case of evasion. In the first experimental condition, audits and fines were imposed immediately after the tax paying decision. In the second experimental condition, tax audits occurred with a time lag of three weeks between the compliance decision and the tax audit.

Results showed that tax payments were higher when the outcome of taxpayers' decision, i.e. the audit and possible fine, was postponed in time. It seems that anticipating the dread while waiting for a probable audit had stronger impact on tax compliance than discounting the probable fine. However, it is not excluded that in reality both processes – dread and discounting – might be at work. Results of this study are discussed in the light of experimental tax research, where providing immediate feedback whether participants are audited or not is common practice. Practical implications for tax policy suggest that it might be advisable to draw attention to the time lag between one's tax return and the auditing process.

*Tax evasion, intertemporal choice, savoring and dread*



*Detlef Fetchenhauer, Julia Pradel, Erik Hoelzl (Eds.)*

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