

ABSTRACT

In a letter to Jean-Baptiste Leroy in 1789, Benjamin Franklin observed that "...in this world nothing can be said to be certain, except death and taxes!" Individuals and businesses, however, certainly employ skilful ways to evade taxes until they are caught, if they ever are. Inevitably, the evolution of taxation systems and their accompanying legal frameworks result in adjustments to evasion/avoidance patterns and mechanisms, which are of interest to economists, social psychologists, and public administrations alike.

The objective of this thesis is to study the effects of the widespread shift towards indirect taxation in the European Union (EU) on firms' tax compliance behaviour. This shift is generally characterised by rising consumption taxes, in particular the value-added tax (VAT) and falling corporate tax rates (CIT). While the policy of radical lowering of the corporate tax burden will likely lead to more honest profit disclosure, my research suggests that firms' evasion practices can migrate to other tax bases, such as social security, where plentiful savings from evasion schemes can be realised. When payroll taxes are significantly above the CIT rates, incentives emerge for companies to under-report wages, since under-stating labour costs is cheaper than paying full contributions. Chapter 1 of this dissertation, titled "The Effect of Low Corporate Tax Rate on Payroll Tax Evasion," explores the phenomenon of wage under-reporting in the context of Bulgaria, which has one of the lowest CIT rates in the EU and yet, due to negative demographic trends and low revenue collection capacity, maintains high payroll contributions.

An interesting trend observed in Central and Eastern Europe, and to a smaller degree in the 'Old' Member States, is that despite dramatic cuts in rates, corporate tax receipts exhibit an upward tendency. The extent to which firms anticipate tax cuts and shift taxable income to years with lower CIT rates becomes an important empirical question in view of its relevance to the deadweight loss of the CIT. Whether accomplished through accounting manipulation or a reduction of outright evasion, intertemporal income shifting can be one possible explanation for the stability of CIT revenue. Evidence of income shifting as well as discussion of tax incentives and the timing of CIT cuts is presented in Chapter 2, "Intertemporal Income Shifting in Expectation of Lower Corporate Tax Rates: The Tax Reforms in Central and Eastern Europe," using firm-level panel data for Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia.

In addition to the greater reliance on indirect taxation, another equally important shift is the global move towards a cashless economy and its implications for tax enforcement. Chapter 3, "The Impact of Cash and Card Transactions on VAT Collection Efficiency," investigates whether the visibility of card payments contributes to better tax compliance in the case of VAT. While no evidence is found that card transactions improve VAT performance in a country-level panel of 26 EU countries, cash payments are shown to be negatively correlated with the VAT-to-consumption ratio.

Considerable revenue dependence on indirect taxation coupled with a rising level of VAT fraud necessitate a reform in VAT's design, and in particular, its method of collection, as proposed recently by the European Commission. The last chapter of the thesis, entitled "Real-time

Collection of the Value-added Tax: Some Business and Legal Implications," analyses the feasibility of a real-time split-payment mechanism (VAT withholding) for electronic transactions, which would eliminate the system of fractionated payments, but would also preclude VAT from passing through private bank accounts. Any technological reform in that direction, however, raises important issues on data privacy and protection, which can be positioned within the broader debate on property rights in an economy steadfastly advancing towards payment digitisation. An even more crucial question is whether tax systems should evolve towards involuntary compliance, given the unprecedented amount of information tax administrations can potentially access.