Tax Evasion by Domestic and Multinational Portuguese Firms: A Bunching Analysis

Risa Pavia\textsuperscript{1,2}

\textsuperscript{1}Center of Operation Research and Econometrics [Louvain] (CORE) – 34, Voie du Roman Pays B-1348 Louvain-la-Neuve, Belgium
\textsuperscript{2}Universidade Nova de Lisboa - School of Business and Economics (NovaSBE) – Portugal

Abstract

In this paper I examine tax evasion by firms earning profits close to zero. I seek to distinguish the behavior of “iceberg” firms, which report only some percentage of their income to the tax authorities, from “ghost” firms, which report no economic activity at all. I further differentiate firm behavior by multinational status, and test the effects of an exogenous shock to the cost of evasion for firms in certain sectors of economic activity.

For the empirical application, I develop a unique identification strategy using a new Portuguese anti-tax evasion measure, and a comprehensive dataset of the annual accounts of Portuguese firms. Using the standard bunching estimation technique of Emanuel Saez and subsequent refinements, I measure tax evasion through bunching of firms at zero profits. I use the exogenous shock to evasion costs to set up a difference-in-differences estimation of the bunching response, testing how the magnitude of bunching at zero changes before and after the reform for firms in treated and untreated sectors. I then compare this difference across firms with a presence only in Portugal and those that have an international parent company.

I find significant bunching at zero profits by all firms in all time periods, indicative of tax evasion around that threshold. The difference-in-differences analysis shows less post-reform bunching by firms in sectors targeted by the 2013 law when compared to other firms, indicating that the law had the intended causal effect of decreasing evasion in those sectors, with a larger difference for multinational firms.

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\textsuperscript{*}Speaker