The Market for Tax Avoidance*

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Abstract

We recognise the existence of a competitive 'tax advice' industry supplying tax avoidance schemes which help taxpayers reduce their tax liability. We model both the demand and the supply sides of this market. It is assumed that there is a continuum of risk-averse taxpayers who buy avoidance schemes from a firm at per-unit market price, subject to a minimum fee induced by the existence of a customer-specific set-up cost. The tax authority may mount a legal challenge to these schemes and, if successful, it can only reclaim the tax owed but cannot levy a fine. The firm faces a legal cost if schemes are challenged by the tax authority and has other fixed costs. Under these assumptions, we find that (1) sufficiently poor taxpayers are excluded from the market for tax avoidance; (2) the per-unit price of the tax avoidance scheme is decreasing in a taxpayer's income under progressive taxation; (3) tax avoidance of taxpayers unconstrained by the minimum fee is price elastic; (4) in equilibrium, taxpayers above an income threshold avoid all their income, but some (constrained) taxpayers bear a higher per-unit price; (5) by simulation, we find a Laffer curve relationship between the tax rate and tax revenue.

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