

Referee Report on: “Optimal capital income taxation with tax evasion”.

The objective of the paper is to build a bridge between optimal capital income taxation and tax evasion, showing how tax evasion can affect the Ramsey rule. More specifically, the paper wants to contribute by testing “the applicability of Sorensen’s framework of optimal capital income taxation in an open economy with constrained ability to tax non-capital incomes, to countries where a significant level of income tax evasion is detected.”

The paper has three introductory literature sections. Section 2 is on empirics and tax evasion, section 3 on well known theoretical model on tax evasion, section 4 discusses generically the possible interaction between tax base mobility and tax evasion. At pag. 14, section 5, (out of 23!) the author introduces the model. Section 6 concludes.

Introductory sections

The paper looks like a very preliminary survey on tax evasion before getting to pag. 14. This is why I think section 2-3-4 should be reduced in one section. More important the author should select just the parts which are important to make clear the point of his paper. This long introduction is sometimes really useless because talking of issues only very far related to the apparent objective of the paper. However I t should be recognized that the not very clear aim of the paper could be the cause of this long and confusing introduction.

The model

The objective of the paper is exactly the most critical issue of this paper. It is not clear what hypothesis the author is theoretically testing and what is the result of this exercise?

What happens in presence of capital mobility to tax rates in an environment with tax evasion? Should tax rates increase or decrease? You do not answer to this question, which could be an interesting one.....you just say that something can happen if tax evasion is non negative.

I can understand that you face with very hard computations when you allow tax evasion to be a function of t , but in this case it would be useful to adopt simplified production functions and see what happens according to different values of parameters.

Last thing: in a paper where you are discussing the role of tax evasion in determining the efficient level of optimal taxes if capital is mobile, you cannot represent tax evasion just as generic function of the tax rate, but I think you should add to the model some micro-economic foundation of the tax evasion activity.