Abstract

We construct an overlapping-generations model where individuals evade capital income tax, imposed on their savings and carry out the long-run analysis, as well as the short-run analysis. We consider that the detection probability depends on the amount of undeclared savings, the interest rate and the detection probability parameter. It is shown that a rise in the capital income tax rate (the detection probability parameter or the penalty rate) lowers (raises) capital stock both in the short- and the long-run. The change in undeclared savings depends on this indirect effect, in addition to the direct effects of such parameters. It is also found that, as opposed to the results of static models, a rise in the tax rate (the detection probability parameter or the penalty rate) can increase welfare in the short-run (the long-run).