

Tax compliance of small enterprises in Greece

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Abstract: The discussion about tax compliance and tax morale has been overstimulated after the eruption the Greek crisis. In this paper, we use data from the Business Environment and Enterprise Performance Survey of the World Bank to explore the determinants of tax compliance of small enterprises in Greece. Our findings indicate that the tax burden and corruption are the primary determinants of non-compliance behaviour in our sample. With regard to the problems faced and exaggerated due to the economic crisis, non-compliance of small enterprises in Greece cannot be evidently considered as a means to survival.

Keywords: Greece; SMEs; tax compliance; tax morale.

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1. INTRODUCTION

Similar to all developed economies, small and medium sized enterprises (SMEs) are the pillar of economic growth in Greece. Since the eruption of the recent global crisis, which emerged as a subprime mortgage and an energy (oil shock of 2007-2008) crisis that was triggered in 2007 and gradually developed into a financial, sovereign debt and eventually, an economic crisis without precedent in post-war economic history, the SMEs in Greece have borne the brunt of the country's economic depression (continuous recession). For example, chain linked volumes of GDP (index 2005 = 100) fell from 109.6 in 2007 (the last year of growth) to 81.3 in 2014 and total unemployment (not seasonably adjusted) rose from 8.4 per cent in 2007 to 26.5 per cent in 2014.²

The aim of this paper is to explore the determinants of small enterprises' tax compliance³ in Greece. Small is defined by the number of employees (less than 49) and tax

² Data from Eurostat (<http://ec.europa.eu/eurostat/web/main/home>) accessed on 7 May 2015. With 2010 as the indexing year, chain linked volumes of GDP fell from 111.1 in 2007 (the last year of growth) to 82.5 in 2014.

³ What we refer to as enterprises' tax compliance is also found in the literature as business/firm/organizational tax compliance.

compliance is explored according to previous findings. The novelty of this study lies on the fact that this is the first attempt to empirically evaluate the determinants of tax compliance from the enterprises' perspectives in Greece.

The paper is organised as follows. The second section gives a background on SMEs and tax compliance. Section 2.1 discusses the development and gives some facts on the role of SMEs in Greece. Section 2.2 gives an overview of the factors determining tax compliance and the motives shaping tax morale. A discussion about the levels of tax compliance and tax morale in Greece takes place in section 2.3. The third section presents the method for exploring the determinants of small enterprises' tax compliance. The fourth section presents the findings of our study. Finally, the fifth section makes some concluding remarks.

2. BACKGROUND

This section gives the necessary background to our study. Section 2.1 gives an overview of the role of SMEs in Greece. Section 2.2 reviews the findings of recent research on tax compliance from the perspective of enterprises. Finally, Section 2.3 discusses the interlinkages of tax compliance with tax morale in Greece and the particular context and role of corruption.

2.1 SMEs in Greece

The statistics about the severe impact of the crisis on output and employment, presented in the beginning of the introductory Section, do not depict a situation that is differentiated from that of which Greek SMEs face. In consistence with previous SBA Fact Sheets about Greece discussing the conditions after the crisis was triggered, the 2014 SBA

Fact Sheet (European Commission, 2014) stresses that Greek SMEs have borne the brunt of the economic crisis in recent years: SME employment fell by 27 per cent and almost one in four of the SMEs that existed in 2008 closed down, reducing the total volume of SME added value by a third of its 2008 levels.

A joint contribution of the partners representing SMEs in Greece (Hellenic Confederation of Professionals et al., 2014) asserts that SMEs in Greece have been affected severely and to a disproportionately greater extent from the economic crisis as compared to large enterprises. They highlight in their policy document that besides the negative impact of economic depression on domestic demand, other negative effects are mainly attributed to austerity measures (tax hikes and reduction of wages and pensions), the centralised nature of businesses which exacerbates regional inequalities and the reluctance of banks to finance Greek enterprises.

Moreover, the policy axes highlighted in the particular document indicate the major issues of concern regarding the future of SMEs development and potential. These are business environment issues (emphasis given to taxation, competition and bureaucracy), structures supporting entrepreneurship (presented as the prerequisite for developing healthy and sustainable business activity) and three issues of primary importance to SMEs activity: namely insurance, infrastructure and access to finance. With regard to taxation, emphasis is given on the size of the tax burden (for example, Greece has the highest VAT rates in the European Union) and the requirement for a stable tax framework that would strengthen the level of security for investors.

2.2 Tax compliance from the enterprises' perspectives

Prior to discussing the drivers of tax reporting from an enterprise's perspective, it has to be noted that there is a debate on the role of tax morale in tax compliance. Nowadays, the debate is less about whether tax morale influences tax compliance and more about how big that influence is. Interestingly, the evidence from field experiments to increase tax compliance shows that while deterrence approaches improve compliance, the case for non-deterrence approaches (tax morale factors) is less conclusive (Hallsworth, 2014).

Lisi (2012) explores tax morale from the enterprises perspective and indicates that tax reporting also depends on trust in authorities. The author demonstrates a theoretical framework that adopts elements of the “slippery slope framework”⁴ and suggests that deterrence by means of enforced compliance alone is not enough for maximising tax reporting.

Alm and McClellan (2012) explore the role of taxes as an obstacle to doing business and the enterprises' tax morale as drivers of the enterprises view of appropriateness of cheating on taxes. Beyond the negative effect of taxes (as an obstacle to doing business), their results indicate the crucial role of tax morale in enterprises' tax compliance, with higher tax morale leading to more tax reporting and lower tax morale leading to less. The authors also find that enforcement efforts (even if better focused) have relatively little impact on tax reporting.

Allon and Hageman (2012) explore the role of institutional factors (corruption and trust) in enterprises' tax compliance in transition economies. The authors find that tax compliance is lower for enterprises with higher levels of tax-related unofficial payments and higher levels of particularized trust (in family and friends). The authors also find that the

⁴ Within this framework, some tax compliance is voluntary and depends on trust in tax authorities and as such, enforced compliance (monitoring probability and expected penalty) alone cannot explain the overall tax compliance.

negative effect of bribing is weakened in the presence of higher generalized trust (in strangers).

Bame-Aldred et al. (2013) explore through a multilevel analysis and from a cross-cultural perspective the role of several important cultural forces in enterprises' tax compliance. Their findings indicate that the more individualistic countries have stronger drives for success at the expense of the collective and have more societal actors that choose deviance or illegitimate means to success. On the contrary, the more humane-oriented societies foster behaviours that reduce deviance in the form of tax evasion. The authors also find that lack of opportunities and lack of ambition to succeed can encourage enterprises in low achievement, low assertive cultures to engage in deviant behaviour like tax evasion.

Another issue affecting enterprises' tax compliance is its cost (reverse relationship), which is reflected in the expenditure of time or money in conforming to government requirements such as legislation or regulation. Schoonjans et al. (2011) find that tax compliance costs are relatively high (over 7 per cent of gross added value) for a sample of Flemish SMEs and support with their findings the regressivity hypothesis, according to which smaller companies face relatively higher compliance costs. Moreover, Eichfelder and Schorn (2012) find that for a set of small German businesses outsourced compliance activities results in significant cost reductions, in contrast to cost reduction efforts through an electronic data interchange with the tax and social insurance authorities or the use of a simplified cash accounting method.

With regard to the relation between the enterprise's size and its compliance, Kamleitner et al. (2012) identify three key aspects that distinguish small business owners' perceptions of their tax situation:

- they are likely to perceive more opportunities not to comply than employed taxpayers,
- they are more likely to experience a lack of meaningful taxation knowledge, and

- they are more likely to face decision frames that render taxes as painful losses.

Finally, with regard to the compliance of large firms, recent literature explores the involvement of global accountancy firms in devising and selling tax avoidance schemes euphemistically marketed as “tax planning” (for example, see Sikka and Willmott, 2013). More specifically, in their survey of incentives and disincentives for tax planning, Graham et al. (2014) find that reputational concerns⁵ explain why firms do not adopt a potential tax planning strategy, while financial accounting incentives have an important role (for example, increasing earnings per share may be an important outcome from a tax planning strategy).

2.3 Tax compliance and tax morale in Greece

Tax morale and tax compliance exhibit a more complicated relation in Greece than in other developed economies. In their discussion about tax and trust in the Greek context, Kaplanoglou and Rapanos (2013) suggest that low tax morale (influenced by distrust both in the government or state institutions and by other taxpayers) remains a major cause for the inability of fiscal authorities to meet projected tax receipts goals. From a theoretical perspective, this form of distrust impacts on two particular tax morale determinants: reciprocity, in which an additional utility term for paying taxes depends in some way on the individual’s relationship to the state and to peer effects and social influences, in which the additional utility term for paying taxes depends on views or behaviours of other individuals (Luttmer and Singhal, 2014: 155).

The particular form of distrust is influenced by phenomena such as clientelism and rent-seeking. Bitzenis et al. (2016) discuss in their literature survey of the informal sector and corruption in Greece about these phenomena and along with the implications of studies on tax

⁵ Possible reputation penalties deter enterprises from adopting tax planning.

compliance behaviour, they reach the conclusion that low tax morale in Greece (reflected through low levels of trust in corrupted state mechanisms) is responsible for the size of the country's informal sector. The authors also provide empirical estimates to support their conclusion and argue about the institutional factors that have to be considered in the formulation of deterrence policies.

3. METHOD

The aim of this paper is to explore the determinants of small enterprises' tax compliance in Greece. The data is from the World Bank's Business Environment and Enterprise Performance Survey and covers 2005. This year is of particular importance, as between 2004 and 2006, SMEs were the main contributor to EU's economic growth (Schmiemann, 2009). In Greece, employment in SMEs grew during that period by more than 10.4 per cent and the drop in the value added of large enterprises was more than offset by SMEs' growth.

We choose to base our model on the approach of Alm and McClellan (2012). However, unlike their analysis, we focus exclusively on Greece and explore further variables in order to get a more specific picture about small enterprises' tax compliance in Greece. Annex Table 1 at the end of the paper presents information about our sample. It defines the variables explored and indicates their frequencies.

Alm and McClellan (2012) assume that an enterprise's tax compliance decisions are affected by enforcement actions of the tax administration and the enterprise's view of the difficulties of paying taxes. According to Equation (1):

$$R_i = \alpha + \beta_1 E_i + \beta_2 O_i + \gamma Z_i + \varepsilon_i \quad (1)$$

Since there is no direct information on a firm's tax morale, R_i is the percentage of sales that the respondent firm i believes a typical firm reports for tax purposes, E_i is a measure of tax enforcement that firm i faces, O_i is a measure of how large an obstacle to doing business the firm finds taxes, and Z_i denotes a vector of control variables that includes the firm's ownership type, its industry, sales and gender of the owner. The error term is denoted ε_i , and α, β and γ are estimated parameters.

In order to explore the dimensions of tax compliance further (following the discussion in Section 2.2) and account for tax morale⁶, the model takes the form of Equation (2):

$$R_i = \alpha + \beta_1 E_i + \beta_2 O_i + \beta_3 I_i + \gamma Z_i + \varepsilon_i \quad (2)$$

The first innovation is O_i , which denotes a vector of variables indicating how large an obstacle taxes are for the business (addressing whether tax rates and tax administration are obstacles to doing business). The other innovation is I_i , which denotes a vector of the instrumental variables correlated with tax morale.

The final version of our model includes the variables depicted in Annex Tables 1 and takes the form of Equation (3):

$$\text{SalRep}_i = \alpha + \beta_1 \text{Insp}_i + \beta_2 \text{Tax}_i + \beta_3 \text{TaxAdm}_i + \beta_4 \text{Cor1}_i + \beta_5 \text{Cor2}_i + \beta_6 \text{Law1}_i + \beta_7 \text{Law2}_i + \beta_8 \text{GProf}_i + \beta_9 \text{Gen}_i \quad (3)$$

With Insp we explore the effect of inspection on tax compliance; Tax and TaxAdm are proxies for the roles of the tax burden and administration as obstacles to doing business; with Cor1 and Cor2 we explore the effect of corruption; Law1 and Law2 are proxies for the cost of compliance; GProf is a proxy for the effect of revenue and Gen for gender differences. We perform a logistic regression and beside the main effects of all the variables in Equation (3),

⁶ Drawing from the discussion of Alm and McClellan (2012), tax morale is linked to the performance of public institutions.

we explore the interactions of Tax_i and TaxAdm_i, Cor1_i and Cor2_i, and Law1_i and Law2_i in order to determine the differences in differences between these terms.

4. FINDINGS

All variables have been tested as response variables for the presence of multicollinearity. The “tolerance” and “variance inflation factor” (VIF) values of each multicollinearity test do not violate the rule of thumb threshold (tolerance > 0.1 and VIF <10). These values are not presented here (nine additional tables are required for doing so) and can be available upon request.

Annex Table 2 indicates that a two-predictor logistic model was fitted to the data to test the factors influencing compliance of small enterprises in Greece. The Hosmer and Lemeshow was insignificant ($p > 0.05$) across all five specifications, suggesting that the model was fit to the data well. According to the findings, the chance of being inspected (Insp) does not seem to play a particular role in tax compliance. The tax burden (Tax) increases the chance of non-compliance, while the odds ratio of tax administration (TaxAdm) is negatively related to non-compliance. The interaction between the variables TaxAdm and Tax reveals that when the tax burden is considered an obstacle to doing business (Tax), the odds ratio of non-compliance is eight times greater from that when the tax administration (TaxAdm) is considered an obstacle. Both forms of corruption seem to influence tax non-compliance with the effect of variable Cor2 being much greater. The interaction between the variables Cor1 and Cor2 reveals that when bribing due to unfair treatment is inescapable (Cor2), the odds ratio of non-compliance is three times greater from the additional payment that get things

done (Cor1).⁷ The fluctuations of variable Law1 across specifications imply that its effect on tax compliance is marginal. On the contrary, the inconsistency and unpredictability of laws and regulations (Law2) are negatively related to tax non-compliance, with statistically significant estimates in all five specifications. The interaction between the variables Law1 and Law2 reveals that the difficulty of obtaining information on laws and regulations (Law1) increases the odds ratio of non-compliance by 0.6 times more than that when laws and regulations are inconsistent and unpredictable (Law2). In contrast to the other two interactions, this is not statistically significant.

With regard to revenue, enterprises with a gross profit (GProf40) of 21-40% of operating costs, versus those with a gross profit (GProf60) of 41-60% of operating costs, have a greater odds ratio of non-compliance by approximately 1.3-1.5. On the contrary, enterprises with a gross profit (GProf10) of 1-10% of operating costs, versus those with a gross profit (GProf60) of 41-60% of operating costs, have a lesser odds ratio of non-compliance by approximately 0.5-0.7. The fluctuations of variable GProf20 across specifications imply that its effect on tax compliance versus that of variable GProf60 is marginal. With regard to gender, males have a lesser odds ratio of non-tax compliance than females. All gross profit and gender estimates across all specifications are not statistically significant.

5. CONCLUSIONS AND IMPLICATIONS

In this paper we explore the impact of formal and informal institutions on tax compliance in Greece, with particular emphasis on the role of weak institutions and corruption. Although there are, nowadays, several studies on the non-tax related factors of tax

⁷ From the way it is defined, it can be considered that Cor1 may sometimes act in favour of enterprises conducting business that is not always according to laws and regulations.

compliance in Greece, considering even the negative impact of clientelism and the behaviour of rent-seeking groups on the tax morale of Greek taxpayers, there is gap in the literature concerning the compliance of Greek enterprises. We aim to make a step towards filling this gap by exploring the factors determining the tax compliance behaviour of small enterprises in Greece.

We perform a logistic regression with data from the Business Environment and Enterprise Performance Survey of the World Bank covering 440 small Greek enterprises in 2005. Our findings indicate that the possibility of being inspected by tax authorities is not associated with steps towards compliance. Even more surprisingly, our findings reveal that the complexity associated with tax administration is also not straightforwardly related to tax non-compliance. The tax burden and corruption in terms of bribing are what clearly determines non-compliance behaviour in our sample.

Complexities in terms of meeting the requirements of laws and regulations, which of course increase the cost of compliance, are also not contributing to non-compliance. On the contrary, inconsistent and unpredictable interpretations of laws and regulations are inversely related to non-compliance.

The size of business revenue reflected in the amount of gross profit as percentage of operating costs is also not clearly related to non-compliance. Neither an increase nor a decrease in the size of gross profit in our sample gives evidence of a straightforward relationship. As such, with regard to the problems faced and exaggerated due to the crisis (pointed in Section 2.1), non-compliance of small enterprises in Greece cannot be evidently considered as a means to survival. Finally, non-compliance appears to occur more in our sample when the principal owner is a female.

The limitations of our study mainly concern the lack of differentiating among industries, since for example, it is expected that it is much easier to evade taxes in the

services sector, the consideration of ownership, since for example, foreign ownership usually involves different cultures and norms, and the exploration of the compliance behaviour of larger enterprises.

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ANNEX

Table 1 – Variables: Definitions and frequencies

Definition (code)	Frequencies (440 cases)	
	Value = 0	Value = 1
Recognising the difficulties that many firms face in fully complying with taxes and regulations, what percentage of total annual sales would you estimate the typical firm in your area of business reports for tax purposes? (SalRep)	178 cases (tax complied, 100%)	225 cases (tax non-complied, less than 100%)
Was your establishment either inspected by the following agencies or required to meet with officials from the Tax inspectorate? (Insp)	215 cases inspected	225 cases not inspected
Can you tell me how problematic are these different factors for the operation and growth of your business: Taxes (Tax)	182 cases (no or minor obstacle)	253 cases (moderate or major obstacle)
Can you tell me how problematic are these different factors for the operation and growth of your business: Tax administration (TaxAdm)	243 cases (no or minor obstacle)	190 cases (moderate or major obstacle)
Thinking about officials, would you say the following statement is always, usually, frequently, sometimes, seldom or never true? “It is common for firms in my line of business to have to pay some irregular “additional payments/gifts” to get things done” with regard to customs, taxes, licenses, regulations, services etc. (Cor1)	241 cases (never or seldom)	131 cases (sometimes, frequently, usually, always)
How often is the following statement true? “If a government agent acts against the rules I can usually go to another official or to his superior and get the correct treatment without recourse to unofficial payments/gifts.” (Cor2)	118 cases (never or seldom)	277 cases (sometimes, frequently, usually, always)
To what degree do you agree with the following statements? Information on the laws and regulations affecting my firm is easy to obtain. (Law1)	113 cases (strongly disagree or tend to disagree)	306 cases (tend to agree or strongly agree)
To what degree do you agree with the following statements? Interpretations of the laws and regulations affecting my firm are consistent and predictable. (Law2)	179 cases (strongly disagree or tend to disagree)	216 cases (tend to agree or strongly agree)
Considering your main product line or main line of services in the domestic market, by what margin does your sales price exceed your operating costs (i.e., the cost material inputs plus wage costs but not overheads and depreciation)? (Gprof)	36 cases (1-10%), 160 cases (11-20%), 214 cases (21-40%), 18 cases (41-60%)	
Is the principal owner (or one of the principal owners) a female?	98 cases (female)	297 cases (male)

Source: World Bank Business Environment and Enterprise Performance Survey (Greece 2005).

Notes: Data concern only small enterprises (2-49 full time employees). The sample consists of 440 cases (missing values included).

Table 2 – Logistic regression analyses of Greek small enterprises' tax compliance

Response variable: SalRep	Exp(b) according to specifications				
Predictors	1	2	3	4	5
Insp	1,007	0,946	0,978	1,008	0,92
Tax	1,426	1,022	1,391	1,474	1,021
TaxAdm	0,689	0,111***	0,73	0,664	0,119***
Cor1	1,318	1,306	0,604	1,305	0,593
Cor2	2,693**	2,652**	1,698	2,702**	1,68
Law1	0,89	0,953	0,893	1,141	1,115
Law2	0,197*	0,197*	0,204*	0,278**	0,251*
GProf10	0,677	0,574	0,681	0,636	0,555
GProf20	1,085	0,979	1,02	1,073	0,91
GProf40	1,544	1,324	1,525	1,52	1,292
GProf60	reference	reference	reference	reference	reference
Gen	0,767	0,695	0,78	0,759	0,704
Constant	1,77	2,403	2,507	1,589	3,177
TaxAdm*Tax		8,515***			8,195***
Cor1*Cor2			3,052***		3,05***
Law1*Law2				0,6	0,727
Hosmer & Lemeshow Test (sig.)	0,908	0,49	0,993	0,899	0,629
Cox & Snell R ²	0,19	0,104	0,101	0,093	0,116
Nagelkerke R ²	0,22	0,14	0,137	0,125	0,156

Notes: *, **, *** indicate significance at the 1%, 5%, and 10% level respectively.

GProf60 is the base of the other GProf categories.