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Presumptive Collection: An Innovative Proposal for a Notoriously Difficult Problem

Leigh Osofsky

University of Miami School of Law, losofsky@law.miami.edu

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Presumptive Collection: An Innovative Proposal for a Notoriously Difficult Problem

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Kathleen DeLaney Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, 67 **Tax L. Rev.** __ (forthcoming 2013), available at [SSRN](#).



Leigh Osofsky

In *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, Kathleen DeLaney Thomas tackles the extensive, and notoriously difficult to address, problem of small business tax evasion. She does so by proposing a novel solution to the problem: presumptive collection of tax liability. Her solution is elegant, balanced, and a great example of how tax law professors can integrate scholarship from other disciplines with their detailed knowledge about tax law and compliance, in order to produce valuable real-world proposals.

Thomas starts off by detailing some of the well-known facts about the rampant tax evasion by small businesses. These businesses, which have high opportunities to evade as a result of the lack of withholding and information reporting, engage in great amounts of evasion. As a result, they are major contributors to the so called “tax gap,” and their evasion threatens the integrity of the tax system.

Thomas does not spend much time lamenting this problem before turning to her proposed solution. Rather than focusing on the lack of information reporting and withholding, which are often discussed as the structural reasons that explain small business tax evasion, Thomas instead offers an insight that is not as frequently examined. Small business owners, Thomas explains, generally do not receive a refund when they file their tax returns, whereas most wage earners (who are much more compliant) do receive a refund when they file their tax returns. From a theoretical perspective, this matters because prospect theory suggests that when individuals face a gains frame (such as when they are receiving a tax refund) they tend to be risk-averse. On the other hand, when individuals face a loss frame (such as when they stand to owe tax liability upon filing a return) they tend to be risk-seeking, which makes them more likely to evade. Thomas offers a fair amount of evidence that this theoretical possibility in fact describes some of taxpayer behavior. Based on this phenomenon, Thomas proposes that advance tax payments be collected from small business owners on a presumptive basis throughout the year. As a result, when small business owners file their tax returns, more of them should find themselves in a gains frame and therefore, as a result of higher risk-aversity, they may evade less.

What is perhaps best about Thomas’s article is the nuanced nature of her proposal. While actual presumptive taxation, popular at times in other countries and in tax theory, can reduce compliance problems, presumptive taxation can also create fairness problems. The traditional income tax system seeks to tax based on some ability

to pay, and presuming tax liability conflicts with that principle. By proposing presumptive collection, but actual taxation based on the traditional income tax system, Thomas adeptly leverages the compliance benefits of a presumptive system, while attempting to preserve the fairness benefits of the traditional income tax system. Thomas also carefully distinguishes presumptive collection from estimated payments. Both result in tax payments being made prior to the actual filing of the year's final income tax return. However, since estimated payments require the taxpayer to make a determination regarding how much tax is owed, they put small business owners in a loss frame, potentially inducing undesirable risk-seeking behavior. Presumptive collection avoids this problem by separating the collection from the taxpayer's decision about how much tax is owed.

Of course, there are some potential problems with the proposal, which Thomas thoroughly and convincingly addresses in the Article. Perhaps the biggest question is whether political realities would allow the proposal to be put in place. That question should not stop scholars, such as Thomas, from thinking deeply about how to improve legal compliance, and advocating for worthwhile ideas. Thomas's innovative approach, her useful integration of prospect theory, and her attention to the details of the tax compliance framework make this idea worthwhile and the Article a pleasure to read.

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