Vanderbilt Journal of Transnational Law

Volume 40
Issue 2 *March 2007*

Article 6

2007

Hand-Holding, Brow-Beating, and Shaming Into Compliance

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Hand-Holding, Brow-Beating, and Shaming Into Compliance: A Comparative Survey of Enforcement Mechanisms for Tax Compliance

ABSTRACT

Tax authorities and policy planners have a variety of tools at their disposal to create mechanisms to encourage and enforce compliance with revenue collection systems. Traditionally, these mechanisms include the possibility of criminal prosecution as well as civil pecuniary sanctions. Despite the dominate role that prosecution and pecuniary sanctions hold internationally, there exists a range of alternative enforcement mechanisms utilized. The United States has recently started to implement nonpecuniary enforcement devices to achieve policy goals, namely the encouragement of participating with the federal taxing system. This Note attempts to take an initial step into exploring the range of international enforcement mechanisms available to policy planners. Then, it contrasts these histories with the more recent development of taxation in the United States. It concludes that given international harmonization, the United States is more likely on the forefront rather than behind the learning curve of enforcement devices. While nonpecuniary devices may hold promise to encourage participation, further research is needed to develop refined devices which live up to that promise.

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I. INTRODUCTION

Tax authorities and policy planners have a variety of tools at their disposal to create mechanisms to encourage and enforce compliance with revenue collection systems. Traditionally, these mechanisms include the possibility of criminal prosecution, as well as civil pecuniary sanctions. Despite the dominate role that prosecution and pecuniary sanctions hold internationally, there exists a range of alternative enforcement mechanisms. The United States has recently started implementing nonpecuniary enforcement devices to achieve its policy goal, namely the encouragement of participating with the federal taxing system. This Note attempts to take an initial step into exploring the range of international enforcement mechanisms available to policy planners. Then, it contrasts these approaches with the more recent development of taxation in the United States. It concludes that, given international harmonization, the United States is more likely on the forefront rather than behind the learning curve of enforcement devices. While nonpecuniary devices may hold promise to encourage participation, further research is needed to develop refined devices which live up to that promise.

II. DEVELOPMENT OF THE TAX COMPLIANCE MECHANISM

> It was only for the good of his subjects that he collected taxes from them, just as the Sun draws moisture from the Earth to give it back a thousand fold.[1]

> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.[2]

> The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.[3]

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1. KALIDASA, RAGHUVAMSAS, RAGHUVANSAD: MAHA KA BYA VATTH (1971) (eulogizing King Dalip, a character in the book, for wise governance). Kalidasa's work is one of the earliest and yet most sophisticated works on political governance.
2. *IRC v. Duke of Westminster*, 19 T.C. 490 (1936) (U.K.).
3. Gregory v. Helvering, 293 U.S. 465, 469 (1935).

A. *Origins of Taxation and Compliance Efforts*

Tax compliance efforts are naturally derivative of their underlying taxation systems. Definitions of tax have undergone perceivable change over time. This is consistent with the developments in types of taxes, enforcement practices, and the governing systems prevalent across the world. Two definitions from different eras and countries summarize this change.

> *England, 1835*: Tax is a tribute or imposition laid upon the subject, which being certainly and orderly rated, was wont to be paid into the King's exchequer.[4]
>
> *India, 1940*: Rate or sum of money assessed on the person or property of a citizen by government for the use of the nation or state; burdens or charges imposed by the legislative power upon persons or property to raise money for public purposes, and the enforced proportional contribution of persons and property levied by the authority of the state for the support of the government and for all public needs.[5]

While it is a matter of popular belief that taxes on income and wealth are a recent creation of the state, which is true enough in the United States, there is extensive historical evidence showing that taxes on income in one form or another were levied in primitive and ancient communities.[6] The etymological development of the word tax is particularly telling. "Taxation" wends its way through the centuries to modern English from the Middle English *taxen*, which was derived from Middle French *taxer* and Mediæval Latin *taxare*.[7] Both the Middle French and Mediæval Latin stem from Latin *tangere*: to touch, feel, rate, compute, or censure.[8]

The selective examples below illustrate the breadth and creativity of pre-modern taxation regimes. These early taxes were often levied on the sale and purchase of merchandise or livestock and were collected in a haphazard manner from time to time.[9] The challenges faced by these early systems echo many of the same difficulties explored today; for example, they provoke questions of

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4. SIR THOMAS E. TOMLINS, THE LAW-DICTIONARY: EXPLAINING THE RISE, PROGRESS, AND PRESENT STATE, OF THE BRITISH LAW: DEFINING AND INTERPRETING THE TERMS OR WORDS OF ART: AND ALSO COMPRISING COPIOUS INFORMATION ON THE SUBJECTS OF TRADE, AND GOVERNMENT (1st Am. ed. 1836).

5. P. RAMANATHA AIYAR, THE LAW LEXICON WITH LEGAL MAXIMS AND WORDS & PHRASES (2nd ed. 1996) (1940).

6. *See infra* text accompanying notes 8–21. *See also* Thomas R. McLean, *The 80-Hour Work Week: Why Safer Patient Care will Mean More Health Care is Provided by Physician Extenders*, 26 J. LEGAL MED. 339, 341–42 (2005).

7. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY UNABRIDGED 2345 (1993).

8. *Id.*

9. Maureen B. Cavanaugh, *Democracy, Equality, and Taxes*, 54 ALA. L. REV. 415, 458 (2003).

ability to pay, equitable valuation, timing consideration, and enforcement mechanisms—the subject of this Note.

Taxation systems throughout history have been challenged by problems of compliance and enforcement. This had led to innovations both in the nature and extent of taxation imposed and the means for ensuring compliance. Nearly 2000 years ago, Cæsar Augustus attempted to levy a tax on the known world.[10] Other governmental executives, perhaps more practically, have used more narrow forms of taxation to help increase compliance. In the Greek, German, and Roman Empires, taxes were levied at times on the basis of turnover and on specific occupations.[11]

For many centuries, particularly in Feudal Europe, revenue from taxes went to the Monarch.[12] An excellent example of this was the *Saladin tithe.* An ecclesiastic extraction, as indicated by its description as a tithe, the *Saladin tithe* was in fact a compulsory tax, which initially was raised to fight the crusades.[13] Contemporaries widely believed that King Henry II of England used the proceeds to fight his own son Richard I and King Phillip II of France, rather than retake Jerusalem.[14] The *Saladin tithe* was a 10% tax on revenues and personal property.[15] Because of the nominally ecclesiastic nature of the tax, the compulsory tithe was assessed by the dioceses and collected by the local clergy rather than through the shires or by the local sheriffs.[16]

Even as such a broad tax with a primitive enforcement system, the *Saladin tithe* was used to encourage state-favored behavior. This policy concern resulted in relatively sophisticated exemptions, perhaps to the chagrin of the progenitors of the modern flat-tax movement:

> This year each man shall give in alms a tenth of his revenues and movables with the exception of the arms, horses and garments of the

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10. *Id.* The hubris of Augustus's attempt to tax the world may actually be quite prescient. Eva Farkas-DiNardo, *Is the Nation of Immigrants Punishing Its Emigrants: A Critical Review of the Expatriation Rules Revised by the American Jobs Creation Act of 2004,* 7 FLA. TAX REV. 1, 11–12 (2005) ("[T]he U.S. may be the only country that taxes all of its citizens, including those residing in other countries, on their worldwide income.").

11. *See generally* Cavanaugh, *supra* note 9, at 442–59.

12. Barbara K. Morgan, *Should the Sovereign Be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy,* 74 AM. BANKR. L. J. 461, 463 (2000).

13. CHRISTOPHER TYERMAN, ENGLAND AND THE CRUSADES, 1095-1588, at 75–76 (1988).

14. *Id.* at 191.

15. Ordinance of the "Saladin Tithe" (1188), *in* 2 ENGLISH HISTORICAL DOCUMENTS, 1042–1189, at 420–21 (David Douglas & George Greenaway eds. 1953) [hereinafter Saladin Tithe].

16. *Id.*

> knights, and likewise with the exception of the horses, books, garments and vestments, and all appurtenances of whatever sort used by clerks in divine service, and the precious stones belonging to both clerks and laymen.[17]

The exceptions were for state-favored investment in national defense—i.e., arms and horses. Additionally, anyone who joined the crusade was exempt from the tithe altogether.[18] Again, the exception was driven by the policy concern of motivating people to join the crusade.

As with modern tax systems, the usefulness of any taxing regime is dependent on a combination of compliance and related enforcement mechanisms for encouraging compliance. Much like its relatively sophisticated exceptions, the enforcement of the *Saladin tithe* tax was similarly complex. The key enforcement mechanism was a blended criminal penalty and alternative sanction, premised again on the ecclesiastic nature of the tax: all clergy and landowners who did not join the crusade were liable for the assessment.[19] Failure to pay would result in imprisonment (the criminal sanction) or excommunication (the alternative sanction).[20] These enforcement remedies were not mutually exclusive, and a noncompliant taxpayer could be subject to both.[21] While taxes in Mediæval England were usually collected through the Office of the Exchequer, a separate office with ten tellers was set up to collect the *Saladin tithe* in Salisbury.[22]

According to historical records, £130,000 was collected from the tithe, which made it the largest tax ever collected in England at the time.[23] A similar tax was levied in France, but Philip II faced significant difficulties in achieving compliance.[24] While the tax was widely loathed in England, the intended purpose was recognized as valuable. [25] In contrast, France lacked the centralized administration

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17. *Id.*

18. *Id.* This is an early predecessor, albeit an immensely more generous one, to modern tax breaks for military service. *See, e.g.*, Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, 117 Stat. 1335 (2003). *See generally* Theodore Paul Manno, *Federal Income Taxation of Soldiers, Sailors, Airmen and Marines*, 50 S.D. L. REV. 293 (2005).

19. Saladin Tithe, *supra* note 15.

20. TYERMAN, *supra* note 13, at 76–77.

21. *See id.* at 76 (stating that those who failed to pay risked both excommunication *and* the possible outcome of a jury trial).

22. SIDNEY KNOX MITCHELL, TAXATION IN MEDIEVAL ENGLAND 13–14 (1st ed. 1951).

23. Nick Barratt, *The English Revenue of Richard I*, 116 Eng. Hist. Rev. 635, 640 (2001) (noting that while this number is subject to debate, estimates place the collection as high as £60,000 from the English shires and £70,000 from English Jewry).

24. Fred A. Cazel, Jr., *The Tax of 1185 in Aid of the Holy Land*, 30 SPECULUM 385, 385 (1955).

25. TYERMAN, *supra* note 13, at 76–77.

system of the shires and faced political opposition from both nobility and Church sources.[26] As these were the primary enforcement actors, their correlation with weaker compliance results renews the charge to modern tax policy analysts to explore enforcement mechanisms as a way of enhancing compliance.

Later, specialized taxes such as the *Saladin tithe* were further expanded with the introduction of poll taxes[27] and specialized duties on processed goods.[28] These specialized taxes were imposed to meet government needs for public goods, including national defense, infrastructure, health, safety, and education.[29] The illustration of the *Saladin tithe* highlights the fact that even unpopular taxes can be effective when combined with strong enforcement mechanisms that target various points of persuasion. Modern enforcement of tax provisions can be achieved by identifying points of persuasion and punishments that provide leverage for effective tax administration.

B. *Enforcement of Tax Provisions: The Theories and Problems of Implementations*

Before engaging in a detailed inquiry of enforcement mechanisms, it is important to recognize the significance of garnering compliance. Low tax compliance can have deleterious effects to the underlying macroeconomics of the taxing authority's government.[30] This problem is particularly acute for developing economies, which are seeking infrastructure and expansion funds, but is a matter of serious concern for any tax regime.

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26. Jean Dunbabin, Book Review, 103 ENG. HIST. REV. 668, 670 (1988) (reviewing JOHN W. BALDWIN, THE GOVERNMENT OF PHILIP AUGUSTS: FOUNDATION OF FRENCH ROYAL POWER IN THE MIDDLE AGES (1986)).

27. Poll Tax is a tax of a fixed amount per person and payable as a requirement for the right to vote.

There used to be poll taxes in some places in the United States; this tax kept many poor people from voting since they could not afford to pay the tax. The twenty-fourth amendment to the Constitution (ratified in 1964) made poll taxes illegal. *See generally*, Robert H. Talbert, *Poll Tax Repeal in Texas: A Three Year Individual Performance Evaluation*, 36 J. POL. 1050, 1050 (1974) (evaluating post repeal changes in body politic composition in Texas); Frank B. Williams, Jr., *The Poll Tax as a Suffrage Requirement in the South*, 1870-1901, 18 J. SOU. HIST. 469, 469 (1952).

28. Tax records on finished goods such as wool, leather, and hides have been used to extract production data. *See, e.g.*, Carla Rahn Phillips, *The Spanish Wool Trade, 1500-1780*, 42 J. ECON. HIST. 775 (1982).

29. AIYAR, *supra* note 5.

30. Robin Burgess & Nicholas Stern, *Taxation and Development*, 31 J. ECON. LIT. 762, 762–63 (1993); *see also* Arindam Das-Gupta et al., *Tax Administration Reform and Taxpayer Compliance in India*, 11 INT'L. TAX & PUB. FIN. 575, 575 n.1 (2004) ("It also causes developing countries to rely excessively on regressive production and trade taxes that generate cascading deadweight losses.").

A robust model for regulatory approaches to encouraging development has been developed in the shape of a pyramid.[31] Initially, a would-be regulator should attempt to persuade the general public to pay taxes (this should be the broadest and most general application of regulatory response and as such takes the form of the base of the pyramid). If regulated actors do not comply with mere gentle persuasion, the regulator should accelerate the persuasion with individual pressure in the form of a legal notice or a warning letter, explaining the consequences of not paying the appropriate taxes.[32] The regulator can then continue to accelerate the consequences to various civil penalties, and determined non-compliance would leading to criminal prosecution.[33] Sociological research has shown that this explicit enforcement pyramid is most likely to garner generalized compliance with rational regulations.[34] It is important to have this gradient of enforcement actions available to the tax regulators. The ability to match the enforcement action with the extent and determinedness of non-compliance helps to mitigate the risk of non-enforcement by regulatory agents.[35] The risk of reluctance to enforce due to mismatched enforcement mechanisms has been demonstrated in other areas of government regulation. If the punishments for drunk driving are perceived as too severe, for example, police will not uniformly enforce the drunk driving laws.[36] Also illustrative of this concept is an example from geopolitics: a country may choose not to invest in becoming a nuclear power because doing so would make it more vulnerable as the country would have a more limited range of responses to an interstate conflict. [37]

For the rational tax policy analyst, implementing a system of enforcement mechanisms that is a responsive and effective tax strategy requires achieving at least three objectives:

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31. JOHN BRAITHWAITE, TO PUNISH OR PERSUADE: ENFORCEMENT OF COAL MINE SAFETY 142 (1985) (discussing a response to coal mine regulation as a hierarchy, where at the bottom, self-regulation is the norm, but gradually becoming government-controlled if self-regulation fails); *see also* IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE REGULATION DEBATE 35 (1992).

32. *See, e.g.*, BRAITHWAITE, *supra* note 31, at 142–43 (discussing civil penalties that could result from a coal mine operator's failure to respond to a notice of a violation).

33. *See, e.g.*, *id.* at 143 (discussing possible criminal sanctions for a coal mine operator's willful violation of health and safety standards).

34. Valarie Braithwaite & John Braithwaite, *An Evolving Compliance Model for Tax Enforcement*, *in* CRIMES OF PRIVILEGE: READINGS IN WHITE-COLLAR CRIME 405, 408 (Neal Shover & John Paul Wright eds., 2001).

35. *See id.* at 408–09.

36. AYRES & BRAITHWAITE, *supra* note 31.

37. Braithwaite & Braithwaite, *supra* note 34, at 409; *see also* William Epstein, *Why States Go—And Don't Go—Nuclear*, 4 ANNALS AM. ACAD. POL. AND SOC. SCI. 16, 20 (1977).

1. to ensure that the full range of credible sanctions are known to the taxpayer,
2. to clearly signal a willingness to cooperate initially with the taxpayer, and
3. to make clear the intention to escalate in the event that cooperation is not forthcoming.[38]

This graduated approach to regulation is also complicit with administrative law theories of institutional legitimacy promoting compliance.[39] It is argued that taxpayers are less likely to be adverse to compliance if the institution is viewed to have acted reasonably and morally in attempting to encourage compliance, gradually escalating the persuasion attempts, rather than acting inconsistently or arbitrarily.[40] A graduated enforcement system that is viewed as procedurally fair by the regulated populace increases compliance, and this fairness bonus is increased when the regulated populace is viewed as trustworthy by a voluntary compliance mechanism.[41]

The explicit regulatory pyramid model controls for a key weakness of other models.[42] It strives to remove from the analysis broad questions of motives and general attribution errors. Notwithstanding the general removal of these "human" elements from the analysis, it is acknowledged that motive can, inevitably will, and even sometimes should, be implicated in determining the enforcement mechanisms utilized and promulgated.[43]

The regulated populace has been described as having a confrontational or adversarial motivational posture towards a taxing regime.[44] Because of this confrontational posture, creating a

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38. Braithwaite & Braithwaite, *supra* note 34, at 409.

39. TOM R. TYLER, WHY PEOPLE OBEY THE LAW 25 (1990) (observing that high level of legitimacy can translate into increased compliant behavior); K. Kuperan & Jon G. Sutinen, *Blue Water Crime: Deterrence, Legitimacy, and Compliance in Fisheries*, 32 LAW & SOC'Y REV. 309, 312 (1998) (comparing deterrence theory with normative theory of compliance); Tom R. Tyler & John M. Darley, *Building a Law-Abiding Society: Taking Public Views About Morality and the Legitimacy of Legal Authorities Into Account When Formulating Substantive Law*, 28 HOFSTRA L. REV. 707, 722–23 (1999) (suggesting that public will defer to regulation if legal authorities are deemed legitimate).

40. *See* Toni Makkai & John Braithwaite, *Procedural Justice and Regulatory Compliance*, 20 LAW AND HUM. BEHAV. 83 (1996).

41. *See id.*

42. Braithwaite & Braithwaite, *supra* note 34, at 410.

43. *Id.* at 410–12.

44. *Id.* at 410 ("[T]he tax system is likely to be seen as oppressive and burdensome, inflexible and unforgiving, and punishing rather than helping taxpayers. Tax officers are likely to be construed as unhelpful, incompetent, mistrustful, and unwilling to consult with taxpayers." [Motivational postures are described as] how we want to and ought to engage with the regulatory system."). *See generally* Valerie Braithwaite et al., *Regulatory Styles, Motivational Postures and Nursing Home Compliance*, 16 LAW & POL'Y 363 (1994).

collaborative framework coextensive with the explicit regulatory pyramid, which realizes the trust and perceptional fairness bonuses, can be particularly difficult for a tax policy planner. The explicit regulatory pyramid allows for both traditional and alternative methods of persuasion. The model acknowledges that cooperation can be used in conjunction with shaming norms to overcome disengaged non-compliance.[45] This is an important consideration for policy planners examining alternative sanctions that utilize shaming to help create social norms of compliance and trust. Consequently, it is recommended that a policy analyst explore the wide options available to create a depth of enforcement mechanisms that are perceptually fair and are able to meet the needs for acceleration. Ideally, this will create a tax system with the perception of "power that is legitimate, and that will be used against those who do the wrong thing."[46]

III. TAX IMPOSITION AND ENFORCEMENT IN VARIOUS COUNTRIES: HISTORICAL AND CURRENT PRACTICES

In order to create a tax system with the depth of enforcement mechanisms that meets the explicit regulatory pyramid model, a tax policy planner should consider various models employed throughout the world. The following reviews the development and practices of taxing regimes in several countries.

A. *India*

India is an important emerging economy, but one with a long tradition of various governance systems.[47] India has a long history of taxation and has had surprisingly complex systems for tax enforcement mechanisms. Ancient Indian texts, including the Manu *smriti*[48] and *Arthaśāstra*[49] have numerous references to taxation. The monarch was empowered to tax the populace, consistent with the

45. Braithwaite & Braithwaite, *supra* note 34, at 412.

46. *Id.* at 411.

47. *See* Robert C. Bird, *Defending Intellectual Property Rights in the BRIC Economies,* 43 AM. BUS. L. J. 317, 317 (2006) (discussing the importance of India and other emerging economies to the world business environment within the realm of Intellectual Property).

48. THE LAWS OF MANU (Wendy Doniger trans., Dover Publications 1992) (1886) [hereinafter MANU].

49. ROGER BOESCHE, THE FIRST GREAT POLITICAL REALIST: KAUTILYA AND HIS *ARTHANSHASTRA* (2002).

dictates of certain moral limitations.[50] The laws provided for direct income taxation and accounted for deductible expenditures.[51] The Manu *smriti* also recognized the political and economic risk of setting tax rates either too high or too low.[52] Previewing the concepts explored above with the explicit regulatory pyramid, the laws advised establishing a tax and enforcement mechanisms that the regulated populace viewed as trust-based.[53] The advised tax rates were:

Traders and Artisans:	1/5th of Net Profit to be paid in specie.
Farmers and Animal Breeders:	A graduated rate of 1/6th, 1/8th, and 1/10th to be paid in depending on individual circumstances.[54]

Additionally, the tax could be paid in some cases by rendering service to the monarch.[55] Modern Indian tax scholars have noted that these ancient tax systems were surprisingly effective at encouraging compliance.[56]

The other primary Indian text that is the source of understanding ancient taxation is the *Arthaśāstra*, a work of general state governance that devotes significant time to public finance.[57] The author of the *Arthaśāstra* recognized the importance of efficient revenue and consequently devoted a significant portion of the work to public finance and revenue systems.[58] The *Arthaśāstra* had extremely broad sources of taxation, including, among many others, taxation of prostitution, gambling, liquor, traders, thief-catchers, mining, and breeding.[59] These taxes were grouped according to

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50. MANU, *supra* note 48, at 141. The limitations were under the *Shastras*, texts which explicate moral duties of all persons. This is an intriguing precursor to modern constitutional limitations on taxation found in most developed economies.

51. *Id.*

52. *Id.*

53. *Id.* (advising against creating a tax system that overly burdened the regulated populace).

54. *Id.*

55. *Id.* at 142.

56. *See* Benoy Kumar Sarkar, *Public Finance in Ancient India*, 97 ANNALS AM. ACAD. POL. & SOC. SCI. 151 (1978) ("Most of the taxes of Ancient India were highly productive.").

57. KAUTILYA, ARTHASASTRA 253-87 (L.N. Rangarajan ed. & trans., Penguin Books 1992) (covering one of several key passages on treasury, revenue collection, and financial rules for civil servants).

58. *See id.* at 253-87 ("All [state] activities depend first on the Treasury. Therefor a King shall devote his best attention to it. . . . From wealth (kosa) comes the power fo the Government (danda).").

59. *Id.* at 260-61. For thief-catchers, see *id.* at 268.

logical associations that modern business authors would describe as "profit centers": fort taxes, country taxes, mine taxes, irrigation taxes, forest taxes, herd taxes, and trade route taxes.[60] The tax system also made erudite taxable duty distinctions between the type and country of origin by applying various levies, such as the *sulka* and the *dwarabahirikadeya* to foreign goods and their importers.[61]

This tax administration appears to have been efficient and effective. While the taxation generally was not progressives, there were adjustments available to deal with the needs of the state. The *Arthaśāstra* provided that the exigencies of the state could merit an unannounced increase in taxation.[62] There was a series of tax exemptions available to encourage public investment by private actors. The *anugrahas* and *parihāras* provided partial tax exemptions, which could be extended for even five years with complete exemption from taxation for construction of typically state-delivered services such as water-works.[63] These provisions helped create a fair and trust-based system, consistent with a well-developed taxing regime. The taxation was recognized as necessary for national defense and state services, but intended to result in a loosely equitable system in which all participants understood and accepted their roles.[64] The *Arthaśāstra* also emphasize rational limitations on taxation based upon the use of and need for taxation. Like the Manu *smriti*, the *Arthaśāstra* limited taxation subject to the moral dictates of *Dharma*.[65] A dereliction in duty by the state could justify the cessation of tax payments and even warrant a refund.[66] However, a failure to pay a just tax would subject the evader to various fines and criminal sanctions.[67]

This division of tax rates, payments, and considerations indicates sophisticated tax systems that are concomitant with the model regulatory system. While several thousand years old, a modern tax planner may find many unique ideas for structuring a tax system within a rational model in the historical development of tax in ancient India.

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60. *Id.* at 256-66.
61. *Id.* at 262.
62. *Id.* at 269-70. ("A King, who finds himself in great financial difficulty, may collect [additional] revenue . . . .").
63. *Id.* at 231.
64. *See* MANU, *supra* note 48, at 185. ("Know that a king who disregards the moral boundaries, who is an atheist and plunders the property of priests, who does not protect (his subjects) but eats them, sinks down.").
65. Kautilya, *supra* note 57, at 253. *See also id.* at 107 (explaining dharma as a fundamental source of law).
66. *Id.* at 90-91.
67. *Id.* at 14.

B. *China*

Like India, China is a key emerging economy on the international scene.[68] Despite an ancient culture and tradition of taxation, modern China faces the difficulties of establishing an effective tax system.[69] Domestic and international tax policy analysts can look to the historical and developmental trends of China in evaluating structural compliance mechanisms.

China is a country with a long tradition of taxation, dating at least as early as the Xia Dynasty (2140–1711 B.C.).[70] The current tax system, however, emerged from various reforms instigated in the mid-1990s.[71] This emerging tax system has been sharply criticized, and calls for additional reform have been raised.[72] After the Chinese Civil War and the establishment of a Maoist Communist Government, China used a single tax system until 1980.[73] However, as part of the process of market reform and eventual World Trade Organization membership, China began to reform its tax system.[74] Since its establishment in 1949, the People's Republic of China has continuously used a single tax system to carry out the functions to taxation management.[75] As late as 1980, the state maintained the tax system and followed a pattern of unified state control over income and expenditures.[76] In 1980, however, in compliance with the requirements of its market integration, China began to explore ways to conduct financial and taxation reform based on the division of income and expenditures and their respective budgets.[77]

Generally, China has followed the advice of the Organisation for Economic Co-operation and Development (OECD) and other industrialized nations by adopting a self-assessment system for income taxation. Taxpayers self-report and calculate their tax

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68. *See* Bird, *supra* note 47, at 333 (discussing the impact of the Chinese economy in the form of industrial copyright piracy at $2.5 billion in 2004).

69. There is documentary evidence of a property tax régime over three thousand years old. *See* JINYAN LI, TAXATION IN THE PEOPLE'S REPUBLIC OF CHINA 1 (1991).

70. A comprehensive tax system during the reign of Emperor Xia Yu was noted by historians around 100 BC. *See* SIMA QIAN, HISTORICAL RECORDS (Raymond Dawson trans., 1994) (n.d.).

71. OECD, POLICY BRIEF—ECONOMIC SURVEY OF CHINA, 2005, at 6, *available at* http://www.oecd.org/dataoecd/10/25/35294862.pdf (last visited Jan. 28, 2007).

72. *Id. See also* Raymond Fisman & Shang-Jin Wei, *Tax Rates and Tax Evasion: Evidence from "Missing Imports" in China,* 112 J. POL. ECON. 471 (2004) (exploring enforcement weakness in China's tariff régime).

73. LI, *supra* note 69, at 16.

74. *Id.*

75. *Id.* at 10–11.

76. *Id.*

77. *Id.*

balance, whereupon the tax authority processes the self-assessment without extensive review.[78] China has, however, begun to allocate more resources to tax audits.[79] The sophistication of its tax system has improved with the use of computers, enabling the identification and flagging of basic audit risk factors. Some factors that have been publicly acknowledged are:

1. continuing losses for more than two consecutive years;
2. expansion of operations despite marginal profits or losses year after year;
3. sudden drops in profits after the expiration of a tax holiday period;
4. severe fluctuations in profits or losses;
5. lower than average margins; and
6. significant or numerous inter-company transactions.[80]

These factors are especially scrutinized in the realm of transfer pricing and advance pricing agreements. China is particularly concerned about multinational corporations being able to arbitrage its tax system and that of another nation to avoid some taxation in both countries.[81] To avoid this, many countries, including China, mandate that pricing agreements include mandatory review by the competent taxing authority.[82] While other countries are more advanced in their advance pricing arrangements and audits, China is becoming increasingly sophisticated in auditing multinational corporations with transfer pricing situations.[83] Audits are being conducted regionally, nationally, and in conjunction with overall income tax audits.[84] Increasing national guidance is helping to harmonize the disparate quality in China's regionalized tax enforcement system.[85]

China continues to impose serious penalties for non-compliance with tax regulations. In order to encourage compliance, minor

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78. Clement Yuen, *Supplement—China: Overview of the Current System and the Coming Tax Reform*, INT'L TAX REV. (CHINA COUNTRY GUIDE), Oct. 2003, at 9–10.

79. *Id.* at 10.

80. *Id.* at 10.

81. Daniel Altman, *Managing Globalization: Old Tax Breaks Fade in New World*, INT'L HERALD TRIB., Apr. 26, 2006, *available at* http://www.iht.com/articles/2006/04/25/business/glob26.php.

82. Steven Tseng et al., *Navigating the APA Process in China; Advance Pricing Arrangement*, INTERNATIONAL TAX REVIEW, Dec. 1, 2006 (discussing that renewals of pricing arrangements are not guaranteed and can be difficult to achieve).

83. *See* John Sterlicchi, *Transfer Trauma*, ACCOUNTANCY AGE, Oct. 12, 2006 (predicting that China will become more aggressive and sophisticated in transfer pricing audits); *see also China targets 15,000 foreign-owned JVs*, ASIA TODAY, Apr. 2006 (discussing increasing emphasis on transfer pricing issues for Chinese tax administrators).

84. Yuen, *supra note* 78 at 10; John Lee, *Transfer Pricing Challenges in China*, INT'L TAX REV., Jul. 1, 2005.

85. Lee, *supra note* 85.

penalties can start at 2,000 Yuan (roughly $250), but more serious infractions may result in pecuniary penalties up to 500% of the tax owed.[86] Additionally, the more serious infractions may be referred for criminal sanctions.[87]

As a tax system in flux, it is difficult to extract a single-stock picture of China's taxation system. Because of this inherent flexibility, however, China stands as a goldmine for observation and experimentation with innovative compliance mechanisms.

C. *Europe, Historically*

From the Roman Empire to Mediæval Europe, various tax regimes utilized a variety of methods to fund public works and governmental expenditure in Europe. King Solomon of the Old Testament pointed to the need for taxes to be applied for civil purposes, and these amounts were increased during times of foreign occupation.[88]

In more sophisticated economies such as the Roman Empire, tax farming developed, but the central powers could not practically enforce their tax policy across a wide realm with slow communication methods and limited regional autonomy.[89] The tax farmers were obligated to raise large sums for the government but were allowed to keep whatever else they raised.[90] Many Christians have understood the New Testament to support the voluntary payment of taxes through Jesus' words, "Render unto Caesar the things that are Caesar's."[91] The New Testament records a variety of taxes, indicating a fairly sophisticated taxation regime, notwithstanding the limitations imposed by geography: a *telos* tax on merchandise or travelers,[92] an annual *phoros* tax on property,[93] a *kensos* or poll tax,[94] and a spiritual excise tax in the form of the temple tax.[95] It is worth

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86. *Yuen, supra note* 78, at 10; Amy L. Sommers & Kara L. Phillips, *Assessing the Tax Administration Law of the People's Republic of China,*18 LOY. L.A. INT'L & COMP. L. J. 339, 362–67 (1996).

87. Sommers & Phillips, *supra* note 86, at 364.

88. 1 *Kings* 4:7; 9:15; 12:4.

89. Adam Melita, Note, *Much Ado About $26 Million: Implications of Privatizing the Collection of Delinquent Federal Taxes*, 16 VA. TAX REV. 699, 701–02 (1997).

90. *Id.*

91. *Mark* 12:17.

92. *Matthew* 17:25.

93. *Luke* 20:22; 23:2.

94. *Matthew* 22:17; *Mark* 12:14.

95. *Matthew* 17:24–27.

noting that there are contrary interpretations of theology on the subjugation to an earthly taxing authority.[96]

Under the feudal system in the Middle Ages, the underpinning of the tax system was an interlocking web of labor, duty, and obligation. Certain systems did not explicitly tax due to the internally generated wealth from government control of land, resources, and international trade; taxation instead took the form of mandatory labor.[97]

Tax farming, a unique enforcement mechanism, occurred primarily in the Egyptian, Greek, and Roman empires, but also was used at times throughout the Greater Middle East.[98] Tax farming is the process of outsourcing the responsibility of tax collection, and at times tax assessment, to private citizens or private, for-profit organizations, freeing the government of the task.[99] An administrative land grant, *Iqta*, evolved into a system of tax farming used by several Islamic groups.[100] Administrative religious leaders would oversee the assignment of land to citizens that were key to the societal structure, including politicians and army officers. Under a sharecropping system, a portion of the income from the land would compensate the *Iqta* holder for his civil service.[101] Because the individual grant holder had a vested interest in collecting his share,

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96. For instance, Christian anarchists generally do not support taxation. *See* David Deleon, *The American as Anarchist: Social Criticism in the 1960s*, 25 AM. QUART. 516, 534 (1973)(discussing right-wing and left-wing, including Christian anarchists, ability to unite on taxation resistance).

97. Taxation in the form of labor has a long and old tradition. It was used in the construction of the Egyptian pyramids and to create the Incan empire, where it was called the *Mita*. Craig Morris and Donald E. Thompson, *Huanuco Viejo: An Inca Administrative Center*, 35 AM. ANTIQUITY 344, 358 (1970).

98. Tax Farming, http://www.spiritus-temporis.com/tax-farming/.

99. Tax farming was often a risky proposition, both for the government and the citizens subject to it, due to agent incentive dilemmas. Consequently it only appeared to have been efficient from an equitable view when paired with strict internal controls. Conceptually, however, an internal control system that requires significant oversight by the government then reduces any efficiency bonus that the government would otherwise receive from outsourcing. The debate is currently raging in U.S. tax policy circles as the U.S. Internal Revenue Service has begun to outsource some tax collection efforts. *See generally* Stephen Barr, *As IRS Scales Back Outsourcing, Union Remains Skeptical*, THE WASHINGTON POST, Nov. 30, 2006, at D5. In fact, it has been reported that the current system of outsourcing will cost the government more than it will garner. *See generally* Government Accountability Office, Report to the Committee on Finance, U.S. Senate, Tax Debt Collection: IRS Needs to Complete Steps to Help Ensure Contracting Out Achieves Desired Results and Best Use of Federal Resources (Sept. 2006), *available at* http://www.gao.gov/new.items/d061065.pdf.

100. Did-You-Mean.com, Tax farming, http://www.did-you-mean.com/Tax_farming.html (last visited Feb. 23, 2007). For a full analysis of the Iqta, *see generally*, BABER JOHANSEN, THE ISLAMIC LAW ON LAND TAX AND RENT: THE PEASANTS' LOSS OF PROPERTY RIGHTS AS INTERPRETED IN THE HANAFITE LITERATURE OF THE MAMLUK AND OTTOMAN PERIOD (Croom Helm, Methuen 1988).

101. *See generally* Johansen, *supra* note 100.

an extensive network of dedicated tax collectors was not required, resulting in an extremely efficient tax system.[102]

C. *United Kingdom, Modern Practice*

The last hundred years have seen revolutionary development in political science and European tax policy. The United Kingdom has a long and stable history of income taxation. Presaging modern tax redistribution theory, Britain passed its first progressive income tax in 1799.[103] The catastrophe of the two world wars left the United Kingdom ravaged both in terms of human life and economic infrastructure. These tragic circumstances, however, paved the way to create a modern and generally efficient tax system.

The cost of war significantly impacted the United Kingdom's taxation system. For example, the standard rate of income tax jumped 24% over the course of World War I.[104] While increases in personal allowances partially eased the burden for non-corporate taxpayers, additional super-taxes represented an increasingly complex tax system, driving by governmental need to fund its defense.[105] Another example of increasing complexity was the inclusion of Excess Profits Duty, which served the dual purpose of revenue raiser and political act to prevent profiteering.[106] The two World Wars allowed for significant experimentation in taxation. For example, the original Excess Profits Duty evolved into an Excess Profits Tax that raised further revenue during World War II.[107] The Excess Profits Tax attempted to track profits that were out of character from pre-war levels by comparing profits to historical peacetime amounts; any excess profits determined under this comparison were taxed at a higher rate, initially 60% but eventually reaching 100% of excess profits.[108]

Another development in taxation in the United Kingdom from the war years was the "Pay As You Earn" or "PAYE" system.[109] The

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102. *Id.*

103. Richard M. Bird & Eric M. Zolt, *Redistribution via Taxation: The Limited Role of the Personal Income Tax in Developing Countries,* 52 UCLA L. R. 1627, 1633, n. 13 (*citing* SVEN STEINMO, TAXATION & DEMOCRACY: SWEDISH, BRITISH, AND AMERICAN APPROACHES TO FINANCING THE MODERN STATE 53–54 (1993).

104. HM Revenue and Customs, Taxation: World War I and a new approach, http://www.hmrc.gov.uk/history/taxhis4.htm (last visited Feb. 23, 2007).

105. *Id.*

106. *Id.*; *see also,* Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation,* 30 J. CORP. L. 1, 32 (2004).

107. Hm Revenue and Customs, *supra* note 104.

108. *Id.*

109. *Id.*

PAYE system is one of systematic source-based withholding, coupled with few deductible items.[110] As such, only a minority of individual taxpayers in the United Kingdom are required to actually submit a tax return.[111]

The United Kingdom has also been progressive in pursuing international agreement on taxation. The first double-taxation treaty was put in place in 1916.[112] Initially much of the U.K.'s international tax harmonization efforts were targeted within its commonwealth, but in 1945 the United Kingdom reached its first income tax treaty with a non-commonwealth country, the United States.[113] The U.K.'s extensive efforts at international tax collaboration have yielded it the most tax agreements of any country.[114]

Value Added Tax, commonly referred to by its acronym VAT, is a comprehensive sales tax regime introduced in the United Kingdom in 1973.[115] Generally, items are taxed at each stage of transactional transformation.[116] Some items are exempt, where the ultimate retail purchase is not taxed, but prior inputs are taxed. In contrast, items designated as "zero rated" are untaxed at both the retail level and the inputs level.[117]

Despite innovations and early policy goals of progressivity, not all segments of the tax base received the benefit of equity considerations. For example, married women were not independently taxed until 1990.[118] The change to individual legal recognition of women in taxation was a long struggle, starting over a century earlier with the Married Women's Property Act of 1882.[119]

> The British scheme had been piloted by Churchill's Chancellor Sir Kingsley Wood from 1940-41. On the day it was to be announced, Wood collapsed and died. But by the end of January 1944, fifteen million people—anyone earning £100 a year or more—had received notices telling them their code number. In the Inland Revenue's first exercise in public relations, staff visited work places to discuss the system with employers and employees.

Id.

110. William J. Turnier, *PAYE as an Alternative to an Alternative Tax System*, 23 VA. TAX REV. 205, 225–26 (2003).

111. *Id.*

112. HM Revenue & Customs, Taxation: Income tax today, http://www.hmrc.gov.uk/history/taxhis7.htm (last visited Feb. 23, 2007) [hereinafter Income Tax].

113. *Id.*

114. In fact, the United Kingdom celebrated being the first country to reach 100 tax treaties with a party. John F. Avery Jones, *The David R. Tillinghast Lecture: Are Tax Treaties Necessary*, 53 TAX L. REV. 1, 3 (1999).

115. *Id.*

116. *Id.*

117. *Id.* William J. Turner, *Designing an Efficient Value Added Tax*, 39 TAX L. REV. 435, 438–42 (1984) (discussing the design of the British VAT system).

118. *Id.*

119. *Id.*

In another vestige of traditionalism, the Crown was historically exempt from income taxation.[120] While Queen Victoria briefly paid income tax in 1842, it was not until 1992 when Queen Elizabeth Regina II elected to pay income tax in a bid to improve public relations vis-à-vis the British people.[121]

D. *Latin America*

Made up of developing countries, most with histories of political upheaval, Latin America presents numerous challenges to domestic policy planners. The international community has criticized many countries in this region for a host of tax issues, including, among others:

1. inefficient: a low average tax realization;
2. overly complex: a tax structure weighted toward indirect taxes with narrow tax bases, multiple rates, and many exemptions;
3. institutional weakness: a limited tax administration capacity;
4. inequitable: a mild redistributive impact; and
5. politicized: a highly centralized tax assignment with tax revenues transferred to sub-national governments in the form of ad-hoc negotiated block grants.[122]

On all of these issues there have been numerous ideas for reformation and restructuring. Perhaps the only item of consensus is the overall need for reform.[123] Latin America has experienced pushes for tax reform before. Notably, in the 1960s, the Organization of American States, the Inter-American Development Bank, and the Economic Commission for Latin America joined forces to conduct a series of

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120. *Id.*

121. *Id.*

122. For a broad perspective of the overall need for reform and debate thereon of the form it should take, see generally RICHARD M. BIRD, TAX POLICY AND ECONOMIC DEVELOPMENT (1992); INTER-AMERICAN DEVELOPMENT BANK, ECONOMIC AND SOCIAL PROGRESS IN LATIN AMERICA (1996); G.P. JENKINS, HARVARD INSTITUTE OF INTERNATIONAL DEVELOPMENT, PERSPECTIVE FOR TAX POLICY REFORM IN LATIN AMERICA IN THE 1990'S (1995); G. PERRY & A.M. HERRERA, INTER-AMERICAN DEVELOPMENT BANK, PUBLIC FINANCES, STABILIZATION AND STRUCTURAL REFORM IN LATIN AMERICA (1994); F. Rodriguez, *Tax Reforms in Latin America 1978-1992: A Comparative Analysis*, 42 SOC. & ECON. STUD. 1 (1993); Parthasarathi Shome, *Taxation in Latin America: Structural Trends and Impact of Administration* (International Monetary Fund [IMF], Fiscal Affairs Department, Working Paper No. 99/19, 1999); Parthasarathi Shome, *Recent Tax Policy Trends and Issues in Latin America*, *in* POLICIES FOR GROWTH: THE LATIN AMERICAN EXPERIENCES 140 (André Lara Resende ed., 1995); Vitno Tanzi, *Fiscal Policy and Economic Reconstruction in Latin America*, 20 WORLD DEV. 641 (1992).

123. *See generally* Rodriguez, *supra* note 122.

conferences on tax reform in Latin America.[124] These conferences, dubbed the Joint Tax Programme, produced a draft model tax code for Latin America and scholarship on tax administration and fiscal policy.[125] Like current efforts, the aim was to stimulate reform and economic growth across the region.[126] The thrust of the Joint Tax Programme reforms were centered on general revenue direct taxation versus earmarking and indirect taxation.[127] Because the tax systems of Latin America were relatively unrefined at the time, the focus was on overall architecture with the result being that functional questions of administrability were given short shrift.[128]

The need to focus on administration and enforcement became apparent, and twentieth century reforms attempted to address these fundamental questions.[129] Recent efforts have focused on pragmatic concerns of neutrality, administrability, efficiency, and substantive equity across the tax base.[130] The outgrowth of these concerns, coupled with the warring factions over direct and indirect taxation, have led to some uniformity across Latin American tax systems.[131] It has been observed that the relatively homogenous tax systems of Latin American countries generally exhibit the following common characteristics:

1. Implementation of broad-based and uniform VAT systems to replace taxes on foreign trade and cascading turnover taxes.
2. Reduction of the highest statutory tax rates and simplification of the personal income tax system.
3. Elimination of preferential treatment for particular sources of corporate income and particular economic sectors.
4. Modernization and strengthening of the institutions involved in tax administration.
5. Increased use of presumptive taxation on capital earnings based on the net or gross values of assets.
6. Wider use of withholding taxes, current or advance payment systems, and adjustments for inflation, tax credits and debits in

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124. JOINT TAX PROGRAM OF THE ORGANIZATION OF AMERICAN STATES AND THE INTER-AMERICAN DEVELOPMENT BANK, PROBLEMS OF TAX ADMINISTRATION IN LATIN AMERICA: PAPERS AND PROCEEDINGS OF A CONFERENCE HELD IN BUENOS AIRES, ARGENTINA, OCTOBER 1961 (1965); JOINT TAX PROGRAM OF THE ORGANIZATION OF AMERICAN STATES AND THE INTER-AMERICAN DEVELOPMENT BANK, FISCAL POLICY FOR ECONOMIC GROWTH IN LATIN AMERICA: PAPERS AND PROCEEDINGS OF A CONFERENCE HELD IN SANTIAGO, CHILE, DECEMBER 1962 (1965).

125. *See id.*

126. Victor Lledo et al., *Governance, Taxes, and Tax Reform in Latin America* 18 (Inst. of Development Studies, Working Paper No. 221, 2004), *available at* http://www.ids.ac.uk/ids/bookshop/wp/wp221.pdf.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

> order to moderate the Olivera-Tanzi effect by which inflation erodes the value of taxes.[132]

These common traits heralded a policy departure away from generally statist principals towards generally free market philosophies.[133] It may be said that Latin American tax planners were trying to insulate the governments' revenue systems from the vacillations in the underlying political system.[134] Due to significant and disruptive inflation, the tax system was seen as another fiscal tool for governments to help mitigate the effects of inflation while shoring up the states' treasuries.[135] Consequently, inflation concerns spurred in no small part the adoption of withholding systems, current payment systems, and inflation adjustments.[136]

The process of tax policy reform is ongoing.[137] Long-term macroeconomic goals, international demands from trading partners, and requirements from foreign investors to access international capital have impacted and limited Latin American countries ability to explore the range of creativity for implementing tax system changes.[138] While much progress has been made, the next round of international economic contraction will likely be telling as to the effectiveness and sustainability of individual reform measures.

E. *Nonpecuniary Enforcement Mechanisms Internationally*

The above has attempted to provide an initial review of several important taxing regimes, through both historical and modern application. Little evidence can be found of long-term use of nonpecuniary enforcement mechanisms. While there is some evidence of their historical use, there is little evidence in the countries surveyed of comprehensive utilization. Indeed, as discussed below, modern trends in taxation appear directed toward collaboration and patterning off of the U.S. model of taxation. Consequently, it is intriguing to find the United States beginning to institute nonpecuniary enforcement mechanisms into aspects of its taxation system.

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132. *Id.* For a comprehensive discussion of the main system reform and improvements, see generally sources cited *supra* note 122.

133. Lledo et al., *supra* note 126, at 18–19.

134. *Id.* at 19.

135. *Id.* Many Latin American countries historically have faced crippling inflation. *See* John Toye, *Fiscal Crisis and Fiscal Reform in Developing Countries*, 24 CAMBRIDGE J. OF ECON. 21 (2000).

136. Lledo et al., *supra* note 126, at 19.

137. *Id.*

138. *Id.*

IV. MULTINATIONAL COLLABORATIVE EFFORTS

Collaboration with other international players in the realm of taxation is, concomitant to individual income taxation in the United States, a fairly recent development. One of the first forays into international tax cooperation occurred in 1998, when the Clinton administration moved to a collaborative, rather than antagonistic, position vis-à-vis the OECD harmful tax competition initiative.[139] The transition to cooperation from unilateral competition is thought to be a necessary response to the increasing globalization of the aggregate world economy.[140] These collaborative efforts are ongoing and, while involving a balance of primarily U.S. international tax goals and multinational free and fair trade concerns, the direction is moving toward integrating the U.S. and international tax regimes.[141]

A. *Collaborative Efforts toward Tax Evasion and Enforcement*

With the Bush administration, many commentators expected less international cooperation; however, collaborative efforts have continued despite domestic and foreign policy struggles with the new administration.[142] The underlying policy appears consistent with the goals pursued by previous administrations. [143]

With the signing of the Williamsburg Memorandum in 2004, tax authorities representing Australia, Canada, the United Kingdom, and the United States established a joint task force to increase collaboration and coordinate information about abusive tax transactions.[144] This joint task force will assist the respective tax administrations in addressing challenges arising from abusive tax transactions.[145] While the tax administrations operate primarily within their own borders, many abusive tax transactions employ strategies that cross borders in order to make it more difficult for domestic taxing agencies.[146] Additionally, many promoters of abusive

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139. Reuven S. Avi-Yonah, *All of a Piece Throughout: The Four Ages of U.S. International Taxation* 28 (University of Michigan Law School, Working Papers Series, 2005).

140. *Id.* at 28, 33.

141. *See* discussion *infra* Part IV.A. (giving an example of on-going efforts); *see also* Income Tax, *supra* note 112 (arguing that the latter age of U.S.-International tax cooperation is towards one of integration).

142. Avi-Yonah, *supra* note 139, at 28–31.

143. *Id.*

144. Memorandum of Understanding for the Creation of a Joint International Tax Shelter Information Centre, U.S.-Austl.-Can.-U.K., Apr. 23, 2004, Internal Revenue Service, *available at* http://www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf [hereinafter Memorandum of Understanding].

145. *Id.*

146. *Id.*

tax planning techniques situate their operations internationally and in extradition-favorable jurisdictions.[147]

> Setting up a joint task force will enable the four countries to:
>
> 1. Share expertise, best practices, and experiences in the field of tax administration to identify and better understand abusive tax transactions and emerging schemes, as well as those who promote them.
> 2. Exchange information about specific abusive tax transactions and their promoters and investors within the framework of the countries' existing bilateral tax treaties.
> 3. Carry out their individual abusive tax transaction enforcement activities more effectively and efficiently.[148]

Officials of the tax administrations will work together in Washington, D.C., during the initial phase of the task force's operations.[149] The respective commissioners will review the operation of the task force after twelve months.[150]

These continuing efforts toward international cooperation will likely push the United States and other developed nations toward further harmonization of their respective tax regimes. There are numerous challenges, however, which may make these first, furtive attempts at collaboration less successful than envisioned by their proponents.

B. *The Role of Cultural and Normative Differences in Multinational Tax Cooperation*

Any multinational cooperative tax regime faces the challenges of cultural and social differences, which come to bear in any comparative law setting. There is currently an expansive body of literature that seeks to quantify the effect that cultural norms have on tax compliance.[151] There has be significant discussion in the academic literature that attempts to quantify how values, social norms, mores, and attitudinal studies can demonstrate change in microeconomic decision-making by independent actors within a given tax regime.[152] To the extent that one can demonstrate differences,

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147. *Id.*

148. Canada Revenue Agency, Statement of Joint Cooperation Regarding Abusive Tax Transactions, Mar. 15, 2004, http://www.cra-arc.gc.ca/tax/nonresidents/tax-e.pdf.

149. Memorandum of Understanding, *supra* note 144.

150. *Id.*

151. *See, e.g.*, Michael A. Livingston, *Law, Culture and Anthropology: On the Hopes and Limits of Comparative Tax*, 18 CAN. J. L. & JURISPRUDENCE. 119, 122 (2005) (reviewing some of the sources of comparative social norm studies in academic literature).

152. *Id.* at 119–20.

these are points of concern that must be addressed in any collaborate tax compliance mechanism. Both traditional and more contemporary economic models have failed to effectively predict or explain these changes.[153] While economic modeling may provide some guidance for international collaborative efforts, its errors limit its applicability.[154] Traditional economic deterrence models fall flat in a cross-cultural setting; these mathematical constructs "predict far too much compliance and far too little tax evasion."[155] Some research indicates that much of the concern about international tax evasion is overblown.[156] Contrary to much of the established economic literature, some behavioral economists have challenged the view of the taxpayer, individual or corporate, as the amoral utility maximizers of post-Keynesian literature.[157] This has been used to help explain why the U.S.'s largely self-reporting tax system is among the world's most efficient.[158] Consequently, it is important to understand the development of enforcement mechanisms in the United States in order to form a comparable analysis.

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153. James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe* 2 (Center. for Research in Economics, Management. & the Arts, Working Paper No. 2004-14, 2004), *available* at http://www.crema-research.ch/papers/2004-14.pdf.

154. *Id.*

155. *Id.*; *see also* James Alm et al., *Why Do People Pay Taxes?*, 48 J. PUB. ECON. 21 (1992); L.P. Feld & B.S. Frey, *Trust Breeds Trust: How Taxpayers Are Treated*, 3 ECON. GOVERNANCE 87 (2002).

156. Alm & Torgler, *surpa* note 153, at 2 (citing article in which Dr. Elffers stated that "the gloomy picture of massive tax evasion is a phantom"). See Henk Elffers, *But Taxpayers Do Cooperate!*, *in* COOPERATION IN MODERN SOCIETY 184-94 (Mark Van Vugt et al., eds., 2000).

157. *Id.* (citing Long and Swingen's argument that "some taxpayers are '. . . simply predisposed NOT to evade'" and referencing Frey and Foppa's 1986 study, which reported that many taxpaying entities "do not even search for ways to cheat at taxes"). *See* Susan B. Long and Judyth A. Swingen, *The Conduct of Tax-Evasion Experiments: Validation, Analytical Methods, and Experimental Realism*, *in* PAUL WEBLEY ET AL., TAX EVASION: AN EXPERIMENTAL APPROACH (1991); Bruno Frey and Klaus Foppa, *Human Behaviours: Possibilities Explain Action*, 7 J. OF ECON. PSYCHOL. 137 (1986).

158. *Id.* (explaining that Pyle harshly critiqued the post-Keynesian view of taxpayers when he stated that "[c]asual observation suggests that not all individuals think quite like [the amoral utility maximizer]"). "Indeed, it seems that whilst the odds are heavily in favour of evaders getting away with it, the vast majority of taxpayers behave honestly." *Id.*

V. ENFORCEMENT MECHANISMS IN U.S. TAXATION

While tax evasion is a criminal offense,[159] the United States has closely, if without acknowledgment, followed the Braithwaite model of effective tax administration.[160] Consequently, the civil tax penalty has been the touchstone of the U.S. tax enforcement arsenal.

A. *Evolution of the Civil Tax Penalty in the United States*

The United States has developed an extensive civil tax penalty system. This system has evolved over a number a years but has been traditional pecuniary in nature. The following survey of federal penalty provisions in the United States demonstrates the rich history of penalty provisions in tax policy, frequent legislative interest in penalty provisions, and the fact that the actuating methodology for penalty provisions has been pecuniary confiscation.

In 1939, the Internal Revenue Code (IRC) in its modern form was codified by Congress.[161] This code systemized a penalty system that had developed under the various taxation statutes that were enacted from 1913 onward.[162] Compliance was the primary purpose of the extensive penalty provisions Congress enacted.[163] These penalties targeted antisocial behavior, which would undermine the confidence in the entire taxation system.[164] For example, Congress imposed sanctions upon taxpayers who failed to file required returns, those who negligently failed to follow the law while reporting income and claiming deductions, and those who fraudulently failed to report income or fraudulently claimed deductions.[165] In 1954, Congress recodified the IRC and readopted such penalties.[166] The Revenue Act of 1962 enacted additional penalties for failure to file information returns and report transfers to trusts.[167] The penalty was calculated as the lesser of either $1,000 or 5% of the unreported amount

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159. I.R.C. § 7201 (2000) (West 2006) (imposing a criminal penalty of up to $100,000 and five years imprisonment for willful evasion of taxes).
160. *See supra* notes 31–46 and accompanying text.
161. Internal Revenue Code of 1939, Pub. L. No. 76-1, 53 Stat. 1 (1939).
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. Internal Revenue Code of 1954, Pub. L. No. 591-736, 68A Stat. 3 (1954).
167. Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960 (1962).

transferred.[168] Congress did, however, provide that reasonable cause may serve as a defense to the penalty.[169]

Tax penalty provisions in the United States are not limited to income taxes. One of the best examples of this can be found in the various penalty provisions Congress enacted in passing the Employee Retirement Income Security Act of 1974 (ERISA).[170] Under ERISA, Congress provided penalties for failures of employers or employee plan administrators to comply with various provisions affecting employee plans. A penalty of $1 per day per participant was adopted with respect to failures to file annual registration statements.[171] This was subject to a $5,000 annual cap, however.[172] A similar penalty of $1 per day per participant was adopted with respect to failures to report a change in a plan's status but with a cap of $1,000.[173] A $10 per-day penalty was adopted for failures to timely file annual information returns but with a cap of $5,000.[174] A $1,000 penalty was adopted for failures to file actuarial reports.[175] A $10 per-failure penalty was also adopted for failures of trustees of individual retirement accounts to report annual contributions to such accounts.[176]

Congress has added complexity to the U.S. federal civil penalty with each major tax bill. With the passage of the Tax Reduction and Simplification Act of 1977,[177] Congress provided taxpayers with relief from additions to tax, interest, and penalties attributable to changes in the tax law that were made by the Tax Reform Act of 1976.[178] With the passage of the Omnibus Budget Reconciliation Act of 1980,[179] Congress adopted a special rule with respect to the estimated tax penalty applicable to corporations whose taxable income exceeded $1 million in any three preceding tax years.[180] As is typical with many modern penalty provisions, Congress provided a safe-harbor exception to the penalty rule: in this case, the penalty would not be imposed if a corporation paid estimated taxes of at least 60% of the

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168. *Id.* at 988.
169. *Id.*
170. Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001–1461 (2000).
171. I.R.C. § 6652(d)(1).
172. *Id.*
173. *Id.* § 6652(d)(2).
174. *Id.*
175. I.R.C. § 6692.
176. *Id.* § 6693.
177. Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126 (1977).
178. *See id.*
179. Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, 94 Stat. 2599 (1980).
180. *Id.* § 1111.

current year's tax liability.[181] The Economic Recovery Tax Act of 1981[182] added several new aspects to the U.S. penalty system, including setting the interest rate for underpayments at the prime rate,[183] increasing the penalty for failure to file an information return,[184] increasing the penalty for withholding information,[185] and increasing the minimum amount to qualify for the safe-harbor for estimated tax payments to 80% of the corporation's ultimate current year's tax liability.[186] The Tax Equity and Fiscal Responsibility Act of 1982[187] changed the interest rate on underpayments to be adjusted at six-month intervals to the average adjusted prime rate charged by commercial banks,[188] added a new $100 minimum penalty for failure to file returns within sixty days of the applicable due dates,[189] and again increased the amount of estimated taxes required to be paid by corporations to 90% of the current year's tax liability.[190] Also, it provided that the Tax Court could award damages up to $25,000 to the United States for frivolously filed petitions or maintained proceedings.[191]

The Technical Corrections Act of 1982[192] granted the U.S. Treasury Secretary or his designee (i.e., the IRS Commissioner) discretionary authority to determine whether overpayment of the windfall profit tax could be taken into account for the purpose of determining the application of estimated tax penalties.[193] When Congress enacted the Interest and Dividend Tax Compliance Act of 1983,[194] it provided a $100 per-instance penalty for failures to timely give required information statements to recipients of interest or dividends.[195] The Deficit Reduction Act of 1984[196] began the targeting of "tax motivated transactions," which included any

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181. *Id.* § 6655(e)(4)(B); Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 731, 95 Stat. 172 (1981).

182. Economic Recovery Tax Act § 1.

183. *Id.* § 711.

184. *Id.* § 723.

185. *Id.* § 721.

186. *Id.* § 731.

187. Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 324 (1982).

188. I.R.C. § 6621.

189. *Id.* § 6651(a).

190. *Id.* § 6655.

191. *Id.* § 6673(a)(1).

192. Technical Corrections Act of 1982, Pub. L. No. 97-448, 96 Stat. 2365 (1983).

193. I.R.C. § 6654.

194. Interest and Dividend Tax Compliance Act of 1983, Pub. L. No. 98-67, 97 Stat. 369 (1983).

195. *Id.* § 105.

196. The Deficit Reduction Act of 1984, Pub L. No. 98-369, § 1, 98 Stat. 494 (1984).

valuation overstatement over 150% of the actual value,[197] any activity with respect to which a loss or an investment credit is disallowed by reason of the at-risk rules,[198] any tax straddle,[199] or use of any accounting method specified as potentially resulting in a substantial distortion of income.[200] Underpayments attributable to any of these tax-motivated transactions would accumulate interest set at 120% of the prevailing rate for non-tax motivated underpayments.[201] Again, the estimated tax penalty provisions were changed to a new, two-pronged safe-harbor: estimated payments were to be based on 80% of the tax shown on a return or 100% of the tax shown on the preceding year's return.[202]

B. *Tax Reform Act of 1986 and Subsequent Penalty Provisions*

The Tax Reform Act of 1986 (1986 Act) was a seminal piece of tax reform legislation that fundamentally overhauled the existing tax code.[203] Under the 1986 Act, a number of important changes were made by Congress, which generally provided for a more flexible, tax-payer friendly penalty system. It provided an abatement of interest accumulation on an underpayment beginning thirty days after a taxpayer files a waiver of restrictions on an assessment of the underlying taxes and ending when a notice and demand is issued to the taxpayer.[204] Interest on underpayments of the accumulated earnings tax were imposed from the due date of the return for the year that the tax is initially imposed and interest rates applicable to underpayments were to be adjusted on a quarterly basis.[205] The 1986 Act also changed the basis for the interest rate to be roughly equal to the federal short-term rate plus 300 basis percentage points and allowed for a higher rate charged than the interest rate paid by the government on overpayments.[206] Congress also clarified that the increased rate of interest for tax motivated transactions, as provided for under the Interest and Dividend Tax Compliance Act of 1983, was applicable to transactions lacking in economic substance.[207] The 1986 Act also provided that the Tax Court may impose sanctions on

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197. *Id.* §§ 144, 155.
198. *Id.* § 144.
199. *Id.*
200. *Id.*
201. *Id.*
202. *Id.* § 411.
203. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).
204. *See* I.R.C. § 6601(c).
205. *See id.*
206. I.R.C. § 6621(a).
207. *Id.*

those who file petitions in the Tax Court without exhausting their administrative remedies.[208]

With the Revenue Act of 1987 (Revenue Act),[209] Congress again modified the application of the estimated tax penalty by providing a safe harbor exception for both large and small corporations that made estimated tax payments equal to 100% of the tax shown on a preceding year's return.[210] The Revenue Act also provided relief to individuals by delaying the application of the increase in estimated payments from 80% to 90% mandated by the 1986 Act to taxable years beginning after December 31, 1987.[211]

The Technical and Miscellaneous Revenue Act of 1988[212] increased the penalty for having a check payable to the Service dishonored by the financial institution upon which it is drawn.[213]

Under the Omnibus Budget Reconciliation Act of 1989,[214] the existing negligence and fraud provisions were substantively revised and reorganized. Congress consolidated all of the penalties relating to the obligation to file accurate tax returns into one code section and provided for two types of fraud penalties.[215] The accuracy-related penalty was systematized at a 20% penalty rate across the various understatement provisions.[216] Congress also provided separate fraud penalties that are dependent upon the actions engaged in by taxpayers; Congress provided that a new fraudulent failure to file penalty is applicable if a taxpayer fraudulently fails to file a return.[217] The penalty for fraudulent failure to file is 15% of the unreported amount per month, or fraction of a month, which is capped at a five-month period.[218] Congress also increased the fraud penalty to 75% of the underpayments attributable to fraud.[219] The Service has the burden of establishing fraud in the first instance, but once it does establish an incident of fraud resulting in an underpayment, the burden shifts to the taxpayer with respect to the entire underpayment.[220] The 1989 Omnibus Act also changed the penalty structures governing tax deposits, converting it to a four-level

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208. *Id.* § 6673(a)(1)(C).
209. Revenue Act of 1987, Pub. L. No. 100-203, § 10000, 101 Stat. 1330 (1987).
210. I.R.C. § 6655(d)(1)(B)(ii).
211. *Id.* § 6654.
212. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988).
213. I.R.C. § 6655.
214. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 102 Stat. 2106 (1989).
215. I.R.C. § 6662.
216. *Id.* § 6662(a).
217. *Id.* § 6651(f).
218. *Id.*
219. *Id.* § 6663(a).
220. *Id.* § 6663(b).

system that increases the penalty the longer the taxpayer goes without making a required deposit.[221] Responding to the growing frustration with the "tax protestor" community, the Tax Court was now permitted to levy a $25,000 penalty on tax protestors, an increase from the previously allowed $5,000 of damages.[222] This change in nomenclature to penalty from damages removed doubt that the sanction could be imposed regardless of actual damages that the United States may have suffered.[223]

The Omnibus Budget Reconciliation Act of 1990[224] introduced the concept of "hot" interest; it created a punitive interest rate on large underpayments of corporations to be equal to the applicable federal rate plus 5%.[225]

With the passage of the Omnibus Budget Reconciliation Act of 1993,[226] the defenses available against the accuracy-related penalty changed to a stricter reasonable basis standard from the previous "not frivolous" standard.[227] Taxpayers could only avoid a substantial understatement penalty through disclosing the position on their returns if the position had a reasonable basis.[228] A merely arguable basis or a colorable claim does not meet this safe-harbor.[229] As part of the Uruguay Round Agreements Act of 1994,[230] Congress eliminated the exception to the substantial understatement penalty when the understatement was attributable to a tax shelter item, even when the corporate taxpayer had substantial authority for its tax positions.[231] Consequently, if there is a substantial understatement of corporate income tax attributable to a tax shelter item, the penalty will apply unless the taxpayer can show "reasonable cause" for its actions.[232]

The Taxpayer Bill of Rights[233] extended the grace period for the payment of taxes without interest to twenty-one calendar days if the total tax liability was less than $100,000 and to ten business days if

221. *Id.* § 6652(c)(1)(A)(ii).
222. *Id.* § 6673(a)(1)(C).
223. *Id.*
224. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990).
225. I.R.C. § 6621(c)(1).
226. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993).
227. I.R.C. § 6662(d)(2)(B)(ii)(II).
228. *Id.*
229. *Id.*
230. Uruguay Round Agreements Act (GATT), Pub. L. No. 103-465, 108 Stat. 4809 (1994).
231. I.R.C. § 6662.
232. *Id.*
233. Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 104th Cong., 2d Sess. (July 30, 1996).

the total tax liability was in excess of $100,000.[234] It also gave the Treasury Secretary the power to waive penalties associated with an inadvertent failure to deposit employment taxes in certain circumstances.[235]

With the Small Business Job Protection Act of 1996,[236] failure to provide information statements to the Service and to recipients for pension payments were included with other informational reporting requirements and associated penalties.[237]

The Taxpayer Relief Act of 1997 was the most substantial overhaul to the tax code since the 1986 Act.[238] Among the many changes, the 1997 act clarified the interaction between foreign tax credit carrybacks and the penalty provisions[239] and when notices regarding tax underpayments by corporations would trigger the hot interest.[240] Further, the act extended the "reasonable cause" standard to more penalties, including the penalty for failure of plan administrators to make reports of voluntary employee contributions to retirement savings plans,[241] the penalty for failures of corporations to make prescribed reports to the Service after issuing qualified small business stock,[242] the penalty for failures of foreign corporations to accurately report their personal holding company tax liability,[243] and the penalty for failures of partnerships or corporations to make required payments after electing to have a tax year other than a required tax year.[244] The act further expanded the net of the substantial understatement penalty by including any partnership, entity, plan, or arrangement that has tax avoidance as a significant purpose, as opposed to a principal purpose standard under prior statutes.[245]

The Internal Revenue Service Restructuring and Reform Act of 1998[246] enacted several key taxpayer protections with respect to penalties. The act requires the Service to provide the taxpayer with specific information about the penalty, including the method by which

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234. I.R.C. § 6601(e)(2)(A).
235. *Id.* § 6656(c).
236. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 104th Cong., 2d Sess. (July 30, 1996).
237. I.R.C. § 6652.
238. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).
239. I.R.C. § 6601(d)(2).
240. *Id.* § 6621.
241. *Id.* § 6652.
242. *Id.*
243. *Id.* § 6683.
244. *Id.* § 7519.
245. *Id.* § 6662(d)(2)(C)(ii)(III).
246. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998).

interest and penalties are calculated.[247] In addition to the calculation, the notice must state the penalty asserted, a citation to the Code section authorizing the imposition of the calculated penalty, and applicable interest.[248] The failure to file penalty, the failure to pay taxes penalty, and the failure to pay estimated taxes penalty are exempted from this revised notice requirement.[249] Also, the 1998 Act shifted the initial burden of proof on issues involving penalties; it became the taxpayer's burden to demonstrate that a defense existed because of reasonable cause.[250]

The American Jobs Creation Act of 2004 (2004 Act)[251] created the new Section 6707A penalty of $10,000 for "natural persons" and $50,000 for any other taxpayer for the failure to include reportable transaction information with the proper return.[252] Additionally, the 2004 Act revised Section 6111 to require attorneys, CPAs, and other "material advisors" who structure or advise on a reportable transaction to file an informational return with the Service that describes the transaction and its potential tax benefits.[253] Failure to file the appropriate informational return subjects the advisor to a $50,000 penalty for most reportable transactions and higher penalties for specifically listed transactions.[254] The 2004 Act requires material advisors to maintain documentation in their files with respect to each reportable transaction upon which they advise, including a list of the clients for whom they have rendered advice connected to the reportable transaction.[255] Failure of a material advisor to make such lists available to the Service within twenty business days upon the Treasury Secretary's written request is penalized $10,000 per day, without limit.[256]

The 2004 Act provides an additional safe harbor mechanism for the risk-averse taxpayer in the form of the new Section 6603. This new provision allows a taxpayer to deposit funds with the Treasury to pay any tax imposed that may be owed but has yet to be assessed

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247. I.R.C. § 6679.

248. *Id.* §§ 6631, 6751, as added by Secs. 3306 and 3308 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 105th Cong. 2d Sess. (July 22, 1998).

249. *See* I.R.C. §§ 6631, 6751.

250. I.R.C. § 7491(c), as added by Sec. 3001 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 105th Cong., 2d Sess. (July 22, 1998).

251. American Job Creations Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).

252. I.R.C. § 6067A.

253. *Id.* § 6111(a)(1), (2).

254. *Id.* § 6111(b)(1)(B)(i).

255. *Id.* § 6111(a).

256. *Id.*

when the funds are deposited.[257] This suspends the accumulation of interest on underpayments, both under the regular interest provisions and punitive interest provisions, as of the day the deposit is made.[258]

C. *Actuating Principles for the U.S. Tax Penalty System*

As the above history details, the pervasive penalty system has been a patchwork of various penalty provisions. Almost without exception, each new tax bill added additional penalties and changed the application of preexisting penalties. In 1954, there were thirteen penalty provisions; in 1988, that number had expanded to over 150 distinct penalties.[259] While some legislation has attempted to simplify the penalty provisions (particularly, the 1989 Act[260] streamlined and reorganized some of the penalty provisions), the overall trend has been the continued expansion of penalty provisions. Today, there are over 600 distinct civil tax penalty provisions.[261]

According to the Service, this complex penalty system is driven by three actuating principles:

> 1. Assisting taxpayers in understanding that compliant conduct is right and noncompliant conduct is wrong;
> 2. Deterring noncompliance by imposing costs on it; and
> 3. Establishing the fairness of the tax system by justly penalizing the noncompliant taxpayer.[262]

In addition to the principles delineated by the Service, the tax revenue effects of these various penalty provisions are not insignificant. In 1995, the Service imposed thirty-four million penalties, resulting in $10 billion being owed to the U.S. Treasury.[263] This amount represents nineteen million penalties levied on individuals yielding $3.5 billion in penalty revenue, and ten million penalties on business returns yielding $4.3 billion in penalty revenue.[264] In 2003, the number of civil penalties imposed had increased to 28.7 billion penalties levied yielding $17.8 billion in

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257. *Id.* 6603(a).

258. *Id.*

259. J. DWIGHT EVANS, TAX FOUNDATION, IS THE TRANSFER PRICING PENALTY COUNTERPRODUCTIVE?—A VIEW THROUGH THE COMMISSIONER'S STUDY 4 (1994).

260. *See supra* text and discussion accompanying notes 214–23.

261. Appendix 1 includes a table listing of virtually every penalty imposed by the IRC along with a brief explanation of the provision.

262. Penalty Policy Statement (P-1-18), Internal Rev. Manual Exhibit 20.1.1.6-1 (Aug. 20, 1998), *available at* http://www.irs.gov/irm/part20/ch01s01.htm.

263. IRS 1995 Annual Data Book, *available at* http://www.irs.gov/taxstats/article/0,,id=97216,00.html.

264. *Id.*

revenues.[265] The breakdown in 2003 included 19.1 billion penalties totaling $5.15 billion in revenues from individual taxpayers and 8.4 billion penalties totaling $7.2 billion from business taxpayers.[266]

D. *Modern Nonpecuniary U.S. Tax Provisions*

While clearly the principle form of enforcement for the U.S. taxing system is the civil penalty, Congress has chosen at times to look outside of this methodology when it would either be constitutionally, administratively, or otherwise undesirable. Consequently there is a body of law where, in attempt to give effect to non-revenue policy goals, Congress has implemented nonpecuniary enforcement devices. These nonpecuniary devices have tended to rely on areas of federal law outside of tax to ameliorate the policy dilemmas and perceived abuses of the IRC. Perhaps the strongest example of this is found in the nonpecuniary attacks at perceived tax-driven behavior in the realm of expatriation.

1. Nonpecuniary Expatriation Provisions

Expatriation is the process of losing, typically through a conscious and purposeful act, one's citizenship.[267] The process of expatriation is typically commenced by taking one of two steps toward extricating oneself from the rights and obligations of citizenship. Most commonly, an individual wishing to expatriate will take a formal oath of renunciation before a U.S. diplomatic or consular official outside the United States.[268] There are, however, several specific acts one can voluntarily commit with the intent of losing citizenship that will have the same effect as a formal renunciation.[269] Given the pervasiveness of the U.S. tax regime and the availability of "tax haven" jurisdictions with less onerous obligations, there can be numerous tax benefits for those willing to expatriate and live by the strict requirements regarding visitation and activities in the United States.

Congress decided to implement changes to the expatriation system in response to several high-profile, high net-worth individuals expatriating for what were largely viewed as tax motivated

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265. IRS 2003 Data Book, Table 27, *available at* http://www.irs.gov/taxstats/bustaxstats/article/0,,id=136474,00.html.
266. *Id.*
267. Michael S. Kirsch, *The Tax Code as Nationality Law*, 43 HARV. J. ON LEGIS. 375, 381–82 (2006).
268. *Id.* at 381.
269. *Id.*

concerns.[270] These examples of expatriation, while a very small percentage of the few people who expatriate in any given year, gave rise to lurid accounts of "cheating America" and calls for action.[271] Consequently, Congress implemented two new nonpecuniary enforcement mechanisms to encourage compliance with federal tax law and keep taxpayers within the U.S. tax net:

(1) Limitations on visits to the United States were extremely restricted, effectively preventing expatriates from reentering the U.S. if they are deemed to be tax motivated expatriates,[272] and

(2) A shaming mechanism that requires the names of all who have renounced their citizenship be published in the Federal Register.[273]

These alternative sanctions have been strongly criticized as being too narrow to achieve their effectiveness goal while, paradoxically, being overly broad in their unintended consequences and costs of administration.[274] For truly affluent, tax-motivated

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270. There has been much discussion in the press of late regarding expatriates. *See, e.g.*, Laurie P. Cohen, *Kenneth Dart Forsakes U.S. for Belize*, WALL STREET J., Mar. 28, 1994, at C1; Robert Lenzner & Phillipe Mao, *The New Refugees*, FORBES, Nov. 21, 1994, at 131; Brigid McMenamin, *Flight Capital*, FORBES, Feb. 28, 1994, at 55.

271. CHARLES LEWIS & BILL ALLISON, THE CHEATING OF AMERICA: HOW TAX AVOIDANCE AND EVASION BY THE SUPER RICH ARE COSTING THE COUNTRY BILLIONS—AND WHAT YOU CAN DO ABOUT IT (2001) (providing a colorful recounting of several prominent expatriations). *See also* DAVID CAY JOHNSTON, PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH—AND CHEAT EVERYBODY ELSE (2003) (discussing the case of Kenneth Dart). Kenneth Dart, an owner of Dart Container Corporation, which manufactures the majority of Styrofoam cups sold in the United States, surrendered his citizenship for tax purposes and became a citizen of Belize. Mr. Dart convinced the Belize government to appoint him as a diplomatic representative to the United States, where he would have opened a consular office in Sarasota, Florida, which not incidentally happened to be Mr. Dart's former hometown and the city where his family still lived. Later, Belize withdrew its request to appoint Mr. Dart as a consular official. *Id.*

272. Illegal Immigration Reform and Immigrant Responsibility Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009-546 (1996). This act contains the controversial "Reed Amendment." *Id.* § 352. The Reed Amendment modified section 212 of the Immigration and Nationality Act, codified at 8 U.S.C. § 1182, which lists various categories of aliens who are inadmissible under the immigration laws. *Id.* The Reed Amendment provides that "[a]ny alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States citizenship for the purpose of avoiding taxation by the United States is inadmissible." *Id.*

273. I.R.C. § 6039G(d)(3).

274. For a thorough critique of the instrumental short-comings of the Reed Amendment, see Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute of Effective Tax Policy*, 89 IOWA L. R. 863, 897–906 (2004). Professor Kirsch also critiques the publication requirement. *Id.* at 906–12.

expatriates, the onus of limited or no access to the United States is not necessarily unpalatable.[275] The change increased the cost of expatriating if the individual expects future visits to the United States, but does not effectively foreclose access to the country.[276]

The effectiveness of the publication requirement is largely limited to those who either (1) seek out the list of expatriates or (2) commonly peruse the federal register, both of which are likely very short lists. The publication requirement is not likely to have any traditional social norm consequence of differential treatment or limited access in private ordering contexts.[277]

2. Other Forms of Nonpecuniary Enforcement Measures at the Federal Level

Other forms of nonpecuniary enforcement exist, which variously encourage compliance and participation in the U.S. tax system. The topic of corporate inversions, whereby a company organized under the laws of the United States changes its place of incorporation to a foreign country, such as Bermuda, in order to reduce its future U.S. tax liability, is another subject which has been subject to public castigation in the popular press.[278] Congress, never content to let a perceived slight go un-ameliorated when splayed in the national press, enacted (as part of the Homeland Security Act of 2002) a ban on these former U.S. corporations from entering into future contracts with the Department of Homeland Security.[279]

3. State Tax Systems Use of Nonpecuniary Enforcement Mechanisms

The use of nonpecuniary enforcement mechanisms is not limited to the federal level. A variety of state and local governments have sought alternative ways to encourage and enforce tax and fiscal policy compliance. Several states and local government revenue departments have, for instance, created tax-shame websites which

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275. *See id.* (discussing the J. Paul Getty family's expatriations over time).

276. *Id.* at 906.

277. *Id.*

278. *See generally* U.S. DEPT. OF TREASURY, CORPORATE INVERSION TRANSACTIONS: TAX POLICY IMPLICATIONS (2002) (discussing generally the process of corporate inversions, the motivations therein, and documenting several high profile inversions). *See also* Mihir A. Desai & James R. Hines, Jr., *Expectations and Expatriations: Tracing the Causes and Consequences of Corporate Inversions*, 55 NAT'L TAX J. 409 (2002).

279. *See* Pub. L. No. 107-296, § 835, 116 Stat. 2135, 2227 (2002) (codified at 6 U.S.C.A § 395 (West Supp. 2003)), *amended by* Homeland Security Act Amendments of 2003, Pub. L. No. 108-7, § 101(2), 117 Stat. 526, 528.

typically publish electronically the most egregious of delinquent tax accounts.[280] This form of "cyber-shaming" has had mixed results but may be an important addition to the development of normative techniques to encourage enforcement.[281]

Also, similar to the federal government, states are using nonpecuniary devices to encourage policy concerns outside of revenue generation. For example, North Carolina, responding to the same corporate inversion concerns with which the federal government is grappling, has passed legislation prohibiting state contracts for goods or services with corporations that have consummated a corporate inversion.[282]

VI. CONCLUSIONS ON NONPECUNIARY ENFORCEMENTS MECHANISMS

Given the wide range of tools that tax authorities and policy planners have at their disposal to create mechanisms to encourage and enforce compliance with revenue collection systems, it makes sense to look at international systems to evaluate the effectiveness of proposed techniques and look for new strategies that may be implemented domestically. Traditionally in the United States, these mechanisms have been limited to the possibility of criminal prosecution as well as civil pecuniary sanctions. New efforts to enact social policy goals have resulted in experimentation with nonpecuniary enforcement devices, but these devices have been based primarily on intuition; consequently the effectiveness of these new nonpecuniary measures has been called into question.

Attempts to look outside of the United States for more effective nonpecuniary enforcement devices may result in greater efficiency, but one must take a critical eye toward international devices and history. With the rise of multinational collaborative efforts and harmonization, the historical trend has been away from nonpecuniary systems and toward a harmonized tax system based roughly on the

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280. *See, e.g.*, http://www.ct.gov/drs/cwp/view.asp?a=1453&q=296114&drsNav=| (listing the Top 100 Connecticut state tax delinquents); http://www.houstontx.gov/taxpayers.html (listing the Houston "seriously" delinquent taxpayers), http://www.revenue.louisiana.gov/sections/cybershame/ (listing the Louisiana delinquent taxpayers); http://www.taxes.state.mn.us/taxes/mce/delinqnet /delinqnet_overview.Shtml (listing the Minnesota delinquent taxpayers); http://www.dor.state.nc.us/collect/ delinquent.html (listing the North Carolina delinquent taxpayers); http://dor.wa.gov/content/doingbusiness/delinquentTaxpayerList.aspx (listing the Washington delinquent taxpayers).

281. *See, e.g.*, Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L. J. 1453, 1493 n.218 (discussing the normative effects of state cybershaming websites).

282. N.C. GEN. STAT. § 143-59.1(a)(2) (2003).

existing U.S. model. Consequently, the United States is likely on the cutting-edge of enforcement devices and research, rather than behind the learning curve. Looking internationally may only provide less refined versions of devices already in use. Additionally, because social norms and cultural differences appear to have a strong influence on the effectiveness of various enforcement devices, what may work for another country may not be effective in the United States. Greater interdisciplinary research is needed to develop more refined models to provide answers to the question of efficient tax compliance. Legal scholars, behavioral economists, sociologists, and anthropologists are all exploring various sides of the question, but it appears that currently the lack of collaboration will result in continued confusion in the field of determining what makes a taxpayer comply and how best to enforce compliance.

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