

What's Wrong with Strict Liability and Nonmonetary Penalties? The Case for Reasonable Fault-Based Civil Tax Penalties and Procedural Protections

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Abstract

Deterrence theory suggests that an increase in penalty rates should increase compliance. There is, however, little real-world evidence that they do. Disproportionate penalties could reduce compliance, if they are perceived as unfair. They could reduce trust for the government and crowd-out intrinsic motives to comply, eroding compliance norms and tax morale. They could also increase disputes, and encourage the government to strain to avoid applying them, thereby reducing economic deterrence. Overly severe penalties could also result in overdeterrence (*i.e.*, reducing the effectiveness of tax incentives), make it difficult to preserve marginal deterrence (*i.e.*, the notion that greater transgressions should trigger larger penalties), and inflict more collateral damage when misapplied.

Some governments have turned to strict liability and nonmonetary penalties instead. In theory, a strict liability penalty can generate more deterrence because it is more likely to be imposed. Strict liability penalties may, however, be viewed as unfair when applied to those who made reasonable, good faith efforts to comply. While strict liability penalties may also seem easier to administer, any apparent administrative savings may be illusory, as penalizing those who acted reasonably probably encourages controversy.

Moreover, even fault-based penalties can be administered as *de facto* strict liability penalties when taxpayers have the burden to show they are not at fault. For example, when a tax agency automates penalty assessments and requires taxpayers to prove they should not be penalized, it creates *de facto* strict liability penalties for those who do not or cannot respond. Thus, the automated administration of penalties can pose risks to tax compliance.

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Like strict liability penalties, nonmonetary penalties (*e.g.*, disclosing the names of those with delinquencies or revoking their licenses or other privileges) may seem unfair, especially when first introduced, because they are not the norm. They also impose greater social costs than fines. They can, however, leverage behavioral science insights, and emerging evidence suggests that visible, nonmonetary penalties can improve tax compliance in some cultures.

Procedural protections can minimize social costs and reduce the risk that nonmonetary penalties will be seen as unfair. Some governments only impose nonmonetary penalties if the taxpayer: presents an egregious case (*e.g.*, a large or repeated delinquency); is not appealing; has been notified that the penalty may apply to him or her; and has declined to pay, declined to establish he or she cannot pay, and has declined to enter a reasonable payment plan or compromise. These protections may blunt economic deterrence; however, they help ensure that disproportionate penalties are not imposed against those who want to comply. With sufficient procedural protections, visible, nonmonetary penalties may be better than overly severe penalties and strict liability penalties.

Finding new ways to penalize and deter conduct that is the norm, however, probably erodes trust for the government, along with voluntary compliance. To improve the effectiveness of penalties, policymakers should reduce the opportunities for noncompliance so that penalties rarely need to be applied. The government can show that it is legitimate and trustworthy by only penalizing behavior that is clearly outside the norm, enhancing the effect of the few penalties that it does impose. For example, it could penalize those who are outside the norm because they are not trying to comply (*i.e.*, via fault-based penalties). Alternatively, if the government could successfully improve tax compliance norms in an industry (*e.g.*, by requiring tax compliance before granting licenses in cash businesses), then, with appropriate safeguards, it could use nonmonetary penalties (*e.g.*, revoking licenses) to reinforce those norms.

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I. Background

A. Penalties Are More than Deterrents

Civil tax penalties are supposed to promote voluntary tax compliance.¹ A Service task force explained that penalties promote compliance by (1) setting standards of behavior, (2) deterring departures from these standards, and (3) showing compliant taxpayers that those who depart from the standards are subject to proportionate and fair penalties.² Nevertheless, economists

¹ See, e.g., Executive Task Force for Internal Revenue Commissioner’s Penalty Study, *A Philosophy of Civil Tax Penalties* (Discussion Draft), reprinted in DAILY TAX REP. (BNA), June 9, 1988, at L-1 [hereinafter IRS Task Force Report I]; H.R. REP. NO. 101-386, at 661 (1989) (Conf. Rep.), as reprinted in 1989 U.S.C.C.A.N. 3018, 3264 (stating in connection with significant civil tax penalty reform, “[t]he IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance.”); I.R.M. 1.2.20.1.1, Policy Statement 20-1 (June 29, 2004) (formerly Policy Statement P-1-18). For an in-depth analysis of the civil tax penalty regime, see NAT’L TAXPAYER ADVOC., 2008 ANNUAL REPORT TO CONGRESS VOL. 2, A FRAMEWORK FOR REFORMING THE PENALTY REGIME 7–15.

² See IRS Task Force Report I, *supra* note 1; Executive Task Force for the Commissioner’s Penalty Study, *Report on Civil Tax Penalties* (Working Draft of Chapters 1–4 and 8), reprinted in DAILY TAX REP. (BNA), Dec. 9, 1988, at L-10; Executive Task Force for the Commissioner’s Penalty Study, *Report on Civil Tax Penalties*, reprinted in *IRS Task Force Releases Penalty Reform Proposals*, 1989 TAX NOTES TODAY 45-36 (Feb. 27, 1989); STAFF OF THE JOINT COMM. ON TAX’N, DESCRIPTION OF TAX PENALTIES (Mar. 24, 1988). For a discussion of these reports, see NAT’L TAXPAYER ADVOC., 2008 ANNUAL REPORT, *supra* note 1, at 2–44; Thomas Hoffman, *Studies of the Code’s Tax Penalty Structure: A Fitful Step Toward Reform*, 43 TAX LAW. 201 (1989).

sometimes make the simplifying assumption that penalties only function to deter noncompliance—that people are motivated by money, cheating only if the likelihood of detection times the penalty is less than the expected gains from cheating.³ For example, if a penalty had a 10 percent chance of applying, it might have to exceed 900 percent to be an effective deterrent.⁴

Given the relatively low penalty and audit rates, however, scholars have concluded that other factors affect compliance.⁵ On one hand, detecting non-compliance generally appears to increase future compliance,⁶ and some lab

³ For a review of the deterrence model and its variations, see Maurice Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323–38 (1972); FRANK A. COWELL, *CHEATING THE GOVERNMENT: THE ECONOMICS OF EVASION* (1990); see also James Alm, *Measuring, Explaining, and Controlling Tax Evasion: Lessons from Theory, Experiments, and Field Studies*, 19 INT'L TAX & PUB. FIN. 54 (2012); James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818 (1998).

⁴ See, e.g., Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968). See also Mark P. Gergen, *Uncertainty and Tax Enforcement: A Case for Moderate Fault-Based Penalties*, 64 TAX LAW REV. 453, 457 n.7 (2010) (summarizing the compliance literature).

⁵ See, e.g., John L. Mikesell & Liucija Birskyte, *The Tax Compliance Puzzle: Evidence from Theory and Practice*, 30 INT'L J. PUB. ADMIN. 1045–81 (2007) (summarizing studies); Richard Lavoie, *Flying Above the Law and Below the Radar: Instilling a Taxpaying Ethos in Those Playing by Their Own Rules*, 29 PACE L. REV. 637, 640–42 (2009) (same); Sarah B. Lawskey, *Probably? Understanding Tax Law's Uncertainty*, 157 U. PA. L. REV. 1017, 1023 (2009) (discussing beliefs about audit probability in the context of the compliance puzzle); Robert Cooter, *The Legal Construction of Norms: Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 VA. L. REV. 1577, 1578–79 (2000) (observing that people pay more in taxes than economic theory would predict); Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905, 1942 n.169 (1987) (arguing that some otherwise unexplained compliance could be attributable to moral and social costs of dishonesty and the transaction costs of enduring an audit). Some have tried to explain how deterrence could produce the observed levels of tax compliance. See, e.g., Mark Phillips, *Reconsidering the Deterrence Paradigm of Tax Compliance* (2011) (unpublished Ph.D. dissertation, University of Chicago); Jack Manhire, *Toward A Perspective-Dependent Theory of Audit Probability for Tax Compliance*, 33 VA. TAX REV. 629 (2014); Jack Manhire, *There Is No Spoon: Reconsidering The Tax Compliance Puzzle*, 17 FLA. L. REV. 623 (2015). Many people, however, appear to comply without regard to economic deterrence. For example, one study found that about 20 percent of the population fully paid a church tax, even though they knew the tax was not enforced. See Nadja Dwenger et al., *Extrinsic and Intrinsic Motivations for Tax Compliance: Evidence from a Field Experiment in Germany*, 8 AM. ECON. J. 203, 204–05 (2016). Similarly, there is no persuasive evidence that the incidence of crime can be explained by the severity of the sanction. See, e.g., Anthony Doob & Cheryl Webster, *Sentence Severity and Crime: Accepting the Null Hypothesis*, 30 CRIME & JUST. 143 (2003).

⁶ See, e.g., NAT'L TAXPAYER ADVOC., 2015 ANNUAL REPORT TO CONGRESS VOL. 2, AUDIT IMPACT STUDY 1–100 (finding self-employed taxpayers who were audited and received a proposed adjustment subsequently increased their reported income). Nevertheless, the probability of audit has not been shown to have a positive effect on compliance for all taxpayer segments. See, e.g.,

experiments suggest that you can raise compliance by raising penalty rates.⁷ On the other hand, there is virtually no real-world evidence that we can increase tax compliance just by increasing penalty rates.⁸ Rather, the available evidence suggests that most taxpayers do not respond to the economic incentive provided by penalties.⁹

Behavioral science (*e.g.*, psychology and behavioral economics) literature suggests that people do what is easy, do what they think others are doing (*i.e.*, follow social norms),¹⁰ and cheat (or comply) only to the extent they can

Jeffrey Dubin & Louis Wilde, *An Empirical Analysis of Federal Income Tax Auditing and Compliance*, 41 NAT'L TAX J. 61, 70 (1988) (providing that "audit class 6 (high income, nonbusiness returns) remains an anomaly—both OLS and IV estimation yield a negative relationship between audit rate and compliance in this case").

⁷ See, *e.g.*, Calvin Blackwell, *A Meta-Analysis of Incentive Effects in Tax Compliance Experiments*, in DEVELOPING ALTERNATIVE FRAMEWORKS FOR EXPLAINING TAX COMPLIANCE 97, 109 (James Alm et al. eds., 2010) [hereinafter DEVELOPING ALTERNATIVE FRAMEWORKS]; James Alm et al., *Estimating the Determinants of Taxpayer Compliance with Experimental Data*, 45(1) NAT'L TAX J. 107, 110 (1992) (finding experiments generally show that the "response to an increase in the penalty rate is positive but small and not highly significant").

⁸ See, *e.g.*, Joel Slemrod et al., *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 38 (2007) (stating that "there has been no compelling empirical evidence addressing how noncompliance is affected by the penalty for detected evasion, as distinct from the probability that a given act of noncompliance will be subject to punishment"); James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818, 842 (1998) (finding only one real-world study that suggested penalties may have a positive effect on compliance, but the effect was not statistically significant). See also Kimberly Varma & Anthony Doob, *Deterring Economic Crimes: The Case of Tax Evasion*, 40 CAN. J. CRIMINOLOGY 165, 175–76 (1998) (surveying Canadians and finding that "25.9% of those who thought that jail would be imposed for evasion . . . had evaded tax. In contrast, only 15.3% of those who thought nothing would happen had evaded tax.").

⁹ See Ann D. Witte & Diane F. Woodbury, *The Effect of Tax Laws and Tax Administration on Tax Compliance: The Case of the U.S. Individual Income Tax*, 38 NAT'L TAX J. 1, 7–9 (1985) (analyzing Service data from the Taxpayer Compliance Measurement Program (TCMP), and finding that the probability (*i.e.*, relative frequency) of audit had a positive effect on subsequent voluntary compliance; the probability of civil and criminal fraud penalties had no significant effect or a negative effect; and the severity of criminal sanctions had no significant effect, except for a small positive effect on high-income, self-employed individuals); NAT'L TAXPAYER ADVOC., 2018 ANNUAL REPORT TO CONGRESS VOL. 2, DO TAXPAYERS RESPOND TO THE SUBSTANTIAL UNDERSTATEMENT PENALTY? ANALYSIS OF BUNCHING BELOW THE SUBSTANTIAL UNDERSTATEMENT PENALTY THRESHOLD 56–76 (finding no statistically significant evidence the substantial understatement penalty affects voluntary compliance).

¹⁰ Messages suggesting that most people pay their taxes (*i.e.*, compliance is the norm) can improve tax compliance. See, *e.g.*, John Hasseldine et al., *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 CONTEMP. ACCOUNTING RES. 171–94 (2007); Michael Hallsworth, *The Behaviorist As Tax Collector: Using Natural Field Experiments to Enhance Tax Compliance* (NBER, Working Paper No. 20007, 2014), <http://www.nber.org/papers/w20007> [<https://perma.cc/V76U-YS94>]; Stewart Kettle et al., *Behavioral Interventions in Tax Compliance: Evidence from Guatemala*, IRS Research Conference (2015), <https://www.irs.gov/pub/irs-soi/15resconhemandez.pdf> [<https://perma.cc/KK55->

maintain a positive self-image (*i.e.*, tax morale).¹¹ These findings are consistent with other lines of tax research, which suggest that trust for the Service, norms, fairness, reciprocity, tax morale, complexity, signaling, reputation, commitment, and other noneconomic factors affect compliance.¹² Similarly, the “slippery slope” framework suggests tax compliance depends not only on the power of tax authorities, but also on the trust that their compliance strategy fosters among taxpayers.¹³

FQM5]. See also James Alm, Kim M. Bloomquist & Michael McKee, *When You Know Your Neighbor Pays Taxes: Information, Peer Effects, and Tax Compliance*, 38 FISCAL STUDIES 587–613 (2017). But see Marsha Blumenthal et al., *Do Normative Appeals Affect Tax Compliance? Evidence from a Controlled Experiment in Minnesota*, 54 NAT’L TAX J. 125–36 (2001) (finding a generic letter which said “[a]udits . . . [show that people] pay voluntarily 93 percent” of what they owe did not improve reporting compliance by Schedule C or F filers; however, recipients may not have believed that audits detected all noncompliance and the letter also stated that “many Minnesotans believe other people routinely cheat,” suggesting the opposite).

¹¹ See generally NAT’L TAXPAYER ADVOC., 2016 ANNUAL REPORT TO CONGRESS VOL. 1, VOLUNTARY COMPLIANCE 50–63; NAT’L TAXPAYER ADVOC., 2016 ANNUAL REPORT TO CONGRESS VOL. 3, BEHAVIORAL SCIENCE LESSONS FOR TAXPAYER COMPLIANCE 44; RICHARD THALER, MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS (2015).

¹² See, e.g., NAT’L TAXPAYER ADVOC., 2007 ANNUAL REPORT TO CONGRESS VOL. 2, NORMATIVE AND COGNITIVE ASPECTS OF TAX COMPLIANCE 138–50 (discussing norms, tax morale, and related factors); NAT’L TAXPAYER ADVOC., 2012 ANNUAL REPORT TO CONGRESS VOL. 2, FACTORS INFLUENCING VOLUNTARY COMPLIANCE BY SMALL BUSINESSES 1–28 (finding that trust and norms correlate with estimated tax compliance among Schedule C filers); FORUM ON TAX ADMINISTRATION: SMALL/MEDIUM ENTERPRISE (SME) COMPLIANCE SUBGROUP, OECD, UNDERSTANDING AND INFLUENCING TAXPAYERS’ COMPLIANCE BEHAVIOR (2010) (discussing norms, trust, and reciprocity); FORUM ON TAX ADMINISTRATION: SME COMPLIANCE SUBGROUP, OECD, RIGHT FROM THE START: INFLUENCING THE COMPLIANCE ENVIRONMENT FOR SMALL AND MEDIUM ENTERPRISES (2012) (same); TOM TYLER, WHY PEOPLE OBEY THE LAW (2006) (discussing legitimacy and trust); Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307–59 (2009) (same); James Alm, Isabel Sanchez & Ana DeJuan, *Economic and Noneconomic Factors in Tax Compliance*, 48 KYKLOS 3–18 (1995) (discussing both economic and noneconomic factors); Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1789 (2000) (discussing norms, reputation, and signaling); Susan C. Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675 (2012) (discussing deterrence, signaling, reputation, separation, and commitment) [hereinafter Morse, *Tax Compliance*]; Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 LOY. U. CHI. L.J. 483, 505–06 (2009) (arguing that small group norms among similar taxpayers are more strongly correlated with tax compliance than large-group or national norms) [hereinafter Morse, *Using Salience*].

¹³ See, e.g., ERICH KIRCHLER & ERIK HOELZL, ECONOMIC PSYCHOLOGY 261–68 (2017); NAT’L TAXPAYER ADVOC., 2017 ANNUAL REPORT TO CONGRESS VOL. 2, AUDITS, IDENTITY THEFT INVESTIGATIONS, AND TAXPAYER ATTITUDES: EVIDENCE FROM A NATIONAL SURVEY 147–94 (using the “slippery slope” framework to explain survey results); ERICH KIRCHLER, THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOR 203–05 (2007); Erich Kirchler, Erik Hoelzl & Ingrid Wahl, *Enforced Versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J.

Penalties could increase or decrease voluntary compliance in different ways through these other factors. For example, they could make compliance easier by clarifying the social and legal norms (*i.e.*, by increasing salience and educating taxpayers about what the government expects them to do and what their law-abiding peers are doing).¹⁴ For this reason, the Service's stakeholders have recommended clarifying the penalty rules.¹⁵ If penalties are visible, they could also shame violators, provide social deterrence, and reinforce compliance norms.

Penalties may also help compliant taxpayers feel that the tax system is fair and that tax compliance is a smart decision, bolstering their self-image and tax morale. Without penalties, compliant taxpayers may feel foolish for complying or that the tax system is unfair, eroding their self-image.¹⁶ Compliant taxpayers, however, are generally risk averse and overestimate the risk of audit

ECON. PSYCHOL. 210–25 (2008); Katharina Gangl et al., *Tax Authorities' Interaction with Taxpayers: A Conception of Compliance in Social Dilemmas by Power and Trust*, 37 NEW IDEAS IN PSYCH. 13–23 (2015); Christoph Kogler, Stephan Muehlbacher & Erich Kirchler, *Trust, Power, and Tax Compliance: Testing the "Slippery Slope Framework" Among Self-Employed Taxpayers* 2 (WU Int'l Taxation Research Paper Series No. 2013-05, 2013); Juan Mendoza, Jacco Wielhouwer & Erich Kirchler, *The Backfiring Effect of Auditing on Tax Compliance*, 62 J. ECON. PSYCHOL. 62, 284–94 (2017) (finding that increasing audits beyond a threshold level reduces compliance, perhaps by reducing trust).

¹⁴ See, e.g., Policy Statement P-1-18 (Aug. 20, 1998), *superseded by* I.R.M. 1.2.20.1.1, Policy Statement 20-1 (June 29, 2004) ("the Service uses penalties to encourage voluntary compliance by . . . helping taxpayers understand that compliant conduct is appropriate and that noncompliant conduct is not."); Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARV. J. ON LEGIS. 111, 113 (2009) ("in addition to their instrumental function of promoting tax compliance, tax penalties serve the critical, transparent, but generally overlooked function of defining tax compliance"). See also Robert Cooter, *Expressive Law and Economics*, 27 J. LEGAL STUD. 585 (1998) (discussing how laws can change norms); Morse, *Tax Compliance*, *supra* note 12, at 693 (same). When a penalty is "salient" it should call attention to itself and the specific conduct that is prohibited. See, e.g., Morse, *Using Salience*, *supra* note 12, at 500 ("Salience here means relevance, prominence and accessibility. A salient communication grabs the attention of the audience."); Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. ON REG. 253 (2011) (noting that "salience is used to describe the degree to which a tax or a tax provision is visible or prominent to the public").

¹⁵ See, e.g., NAT'L TAXPAYER ADVOC., 2008 ANNUAL REPORT, *supra* note 1, at 1; ABA Section of Taxation, *ABA Tax Reform & Simplification Project* (2011), <https://www.americanbar.org/content/dam/aba/events/taxation/taxiq-fall11-colvin-taxreformcomments.authcheckdam.pdf> [<https://perma.cc/3AL3-LWRK>]; AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, REPORT ON CIVIL TAX PENALTIES: THE NEED FOR REFORM (Apr. 11, 2013), <https://www.aicpa.org/Advacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-report-civil-tax-penalty-reform-2013.pdf> [<https://perma.cc/5HBT-ATRW>].

¹⁶ See, e.g., Policy Statement P-1-18 (Aug. 20, 1998), *superseded by* I.R.M. 1.2.20.1.1, Policy Statement 20-1 (June 29, 2004) (stating that "the Service uses penalties to encourage voluntary compliance by . . . establishing the fairness of the tax system by justly penalizing the noncompliant taxpayer").

and detection.¹⁷ Therefore, most taxpayers are unlikely to feel foolish for complying even if they know that some people are willing to risk penalties.

In summary, research suggests that people are most likely to follow rules when they are fair, easy to understand and implement, and established by a legitimate, trustworthy, and fair authority, provided the authority seems strong enough to detect and penalize noncompliance, and compliance appears to be the norm. In such cases, compliance seems “easy,” “good,” and “smart.” Thus, penalties can promote voluntary compliance, even if they do not provide full economic deterrence for everyone, provided they are not so low or so rarely enforced that compliant taxpayers feel foolish.

B. *Disproportionate Penalties Can Backfire*

Despite the lack of empirical support, economic theory may suggest that if we make penalties more severe, we can achieve the same level of deterrence with fewer audits.¹⁸ Nevertheless, this approach may require the government to impose severe penalties that are likely to be perceived as unfair.¹⁹ Overly severe penalties can also make it difficult to preserve marginal deterrence (*i.e.*, the notion that greater transgressions should trigger larger penalties).²⁰ They

¹⁷ See John T. Scholz & Neil Pinney, *Duty, Fear and Tax Compliance: The Heuristic Basis of Citizenship Behavior*, 39 AM. J. OF POL. SCI. 490 (1995) (finding that citizens who report a greater commitment to obey tax laws systematically overestimate the expected penalty for noncompliance). See also Daniel Kahneman et al., *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5(1) J. ECON. PERSP. 193–94, 197–203 (1991), <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.5.1.193> [<https://perma.cc/U6T6-88AC>] (finding that people will pay more to avoid the loss of something they have (*e.g.*, an endowment) than to acquire it); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263, 278–79 (1979) (same).

¹⁸ See, *e.g.*, Luigi A. Franzoni, *Tax Compliance*, in ENCYCLOPEDIA L. & ECON. 25 (Boudewijn Bouckaert & Gerrit De Geest eds., 2008) (“[G]iven that raising the audit rate requires public resources while an increase in the penalty rate does not, the end result is likely to be one with Draconian but rare punishment, a rule such as ‘hang evaders with probability (close to) zero.’”); Kyle Logue, *Optimal Tax Compliance and Penalties when the Law is Uncertain*, 27 VA. TAX REV. 241, 266 (2008) (explaining the theory that “Becker’s solution is to spend relatively little on detection, but to increase the ex post penalty until the potential perpetrator is induced ex ante to act as if the probability of detection were one”).

¹⁹ As noted by one commentator:

If a taxpayer underpays her income by \$100, and the particular mistake has only a 1% chance of being detected, it seems intuitively unfair that the one person out of 100 who gets caught will have to pay \$10,000 while the other ninety-nine go free. Such an outcome seems especially problematic when the activity in question, from an ex ante perspective, is not clearly illegal but is only of uncertain legality.

Logue, *supra* note 18, at 268.

²⁰ See George Stigler, *The Optimum Enforcement of Laws*, in ESSAYS IN THE ECONOMICS OF CRIME AND PUNISHMENT 57 (Gary S. Becker & William M. Landes eds., 1974), <http://www>.

inflict more collateral damage when misapplied (*i.e.*, applied to compliant taxpayers).²¹ They may result in overdeterrence, increase the incentive for disputes,²² and encourage the Service or the courts to strain to avoid applying them, which could actually reduce their value as deterrents.²³

Moreover, other theories suggest that penalties may reduce compliance if they seem unfair or otherwise undermine trust.²⁴ Trust in government, the tax laws, and the Service is correlated with voluntary compliance, and the imposition of penalties perceived as unfair is correlated with noncompliance.²⁵ A study of tax shelter investors in Australia found that the mere threat of disproportionate penalties undermined trust for a very long time.²⁶ A taxpayer could use this perceived lack of fairness to justify noncompliance.²⁷

The perception that penalties are unfair could also make noncompliance consistent with a positive self-image (*i.e.*, reduce tax morale). Behavioral science experiments show that people reciprocate by punishing unfair behavior even if doing so is not in their economic self-interest.²⁸

nber.org/ chapters/c3626.pdf [https://perma.cc/L36U-G7JB] (“If the offender will be executed for a minor assault and for a murder, there is no marginal deterrence to murder.”).

²¹ See *id.* at 57 (observing that punishing the innocent involves “costs of both resources and loss of confidence in the enforcement machinery . . . [and] encourages the crime because it reduces the marginal deterrence to its commission”).

²² See, e.g., Okan Yilankaya, *A Model of Evidence Production and Optimal Standard of Proof*, 35 CAN. J. ECON. 385–409 (2002) (suggesting that at low penalty levels, both the guilty and innocent should pay a penalty rather than contest it; at moderate levels, only the innocent should spend resources to contest it, and at severe levels the prosecutor, the guilty, and the innocent should spend resources to contest it, increasing the likelihood of both false acquittals and false convictions).

²³ See, e.g., Franzoni, *supra* note 18, at 17–18.

²⁴ See, e.g., Bruno S. Frey & Lars P. Feld, *Deterrence and Morale in Taxation: An Empirical Analysis* (CESifo Group, Working Paper No. 706, 2002) (suggesting that treating taxpayers with respect increases their tax morale, but relying solely on deterrence prompts taxpayers to engage in active tax avoidance).

²⁵ See *id.*; NAT’L TAXPAYER ADVOC., 2012 ANNUAL REPORT, *supra* note 12, at 1–70 (finding that among small business respondents, trust in government, the tax laws, and the Service are more significantly associated with apparent voluntary compliance by small businesses than most other factors including economic deterrence).

²⁶ See, e.g., Bevan Murphy, Kristina Murphy & Malcolm Mearns, *The Australian Tax System Survey of Tax Scheme Investors: Methodology and Preliminary Findings for the Third Follow-Up Survey* 7–9 (Alfred Deakin Res. Inst., Working Paper No. 13, 2010).

²⁷ One survey has consistently found that the strongest factor influencing compliance is personal integrity. See, e.g., Pacific Consulting Group, *Comprehensive Taxpayer Attitude Survey* 20–21 (Nov. 2017) (finding for every year since 2008, at least 90 percent of survey respondents said personal integrity had somewhat of an influence or a great deal of influence on their compliance decision). Accord Marjorie E. Kornhauser, *Tax Compliance and the Education of John (and Jane) Q. Taxpayer*, 121 TAX NOTES (TA) 737 (Nov. 10, 2008) (surveying studies finding that personal integrity and tax morale drive voluntary compliance).

²⁸ See, e.g., Matthew Rabin, *Incorporating Fairness into Game Theory and Economics*, 85 AM. ECON. REV. 1281–302 (Dec. 1993), <https://people.hss.caltech.edu/~camerer/NYU/07-3>

The Service generally acknowledges that excessive or undeserved penalties can discourage compliance.²⁹ Congress has also enacted burden shifting and managerial approval provisions in an apparent attempt to improve their perceived fairness.³⁰ Similarly, the Organization for Economic Cooperation and Development has concluded that:

[t]axpayers are more likely to increase voluntary compliance when they believe that the revenue authority acts in a way that is fair and reasonable
[T]axpayers tend to regard tough enforcement action as more procedurally fair when persuasion has been tried first.³¹

Further, an excessive focus on the use of audits and penalties as a lever has the potential to crowd-out intrinsic motives to comply.³² It could do so by

Rabin.pdf [https://perma.cc/8CJ5-RG6Z]; Colin Camerer & Richard Thaler, *Ultimatums, Dictators and Manners*, 9 J. ECON. PERSP. 209–19 (1995), <http://authors.library.caltech.edu/22127/1/2138174%5B1%5D.pdf> [https://perma.cc/L68U-MTJN]; Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998), http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2797&context=fss_papers&sei-redir=1 [https://perma.cc/M7JE-LD8Q].

²⁹ I.R.M. 20.1.1.2.1(10) (Nov. 25, 2011) (“Penalties best aid voluntary compliance if they support belief in the fairness and effectiveness of the tax system.”); I.R.M. 4.26.16.6(3) (Nov. 6, 2015) (“[E]xaminers must consider whether the issuance of a warning letter and the securing of delinquent FBARs, rather than the determination of a penalty, will achieve the desired result of improving compliance in the future.”); I.R.M. 20.1.1.1.3(4) (Dec. 11, 2009) (“A wrong [penalty] decision, even though eventually corrected, has a negative impact on voluntary compliance.”).

³⁰ See, e.g., Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, §§ 3001(a), 3306, 112 Stat. 726 (codified at section 7491(c) (shifting the burden of production to the Service for penalties) and 6751 (requiring supervisory approval of penalties)). Before these provisions were enacted, the Senate noted protections were needed because “taxpayers are entitled to an explanation of the penalties imposed upon them . . . [and] penalties should only be imposed where appropriate and not as a bargaining chip.” S. REP. NO. 105-174, at 65 (1998). Some have argued that the Service and the Tax Court “unfairly penalized unrepresented taxpayers by ignoring Congressional safeguards [that were enacted] in reaction to widely reported Service abuses.” See Del Wright, Jr., *Improperly Burdened: The Uncertain and Sometimes Unfair Application of Tax Penalties*, 35 VA. TAX REV. 1, 2 (2015). The provisions are subject to continuing controversy. See, e.g., Graev v. Commissioner, 147 T.C. No. 16 (2016), *superseded and modified in part by*, 149 T.C. No. 23 (2017); Chai v. Commissioner, 851 F.3d 190 (2d Cir. 2017). A detailed discussion of the controversy is beyond the scope of this article.

³¹ FORUM ON TAX ADMINISTRATION COMPLIANCE SUB-GROUP, OECD, COMPLIANCE RISK MANAGEMENT: MANAGING AND IMPROVING TAX COMPLIANCE 47, 70 (Oct. 2004), <http://www.oecd.org/dataoecd/44/19/33818656.pdf> [https://perma.cc/FS5R-56NN] (discussing the so-called “responsive regulation” model).

³² See, e.g., Norman Gemmill & Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT’L TAX J. 33–58 (Mar. 2012) (suggesting that audits of compliant taxpayers may reduce voluntary compliance); NAT’L TAXPAYER ADVOC., 2015 ANNUAL REPORT, *supra* note 6, at 1–100 (finding taxpayers who were audited but did not receive an additional assessment subsequently reduced their reported income); Jason DeBacker et al., *Legal Enforcement and Corporate Behavior: An Analysis of Tax Aggressiveness After an Audit*, 58 J.L.

signaling either that the government is unfair or that those who comply only do so because of penalties, rather than because of a collective tax morale or compliance norm.³³

C. *Sophisticated Businesses May Be Easier to Deter*

Although most people probably do not make decisions based solely on a cost-benefit analysis,³⁴ some probably do. It makes sense for this group to face a higher risk of detection than most other taxpayers. Indeed, they do. For example, the risk of audit is presumably higher for those who cheat because most of the Service's audit selection formulas are not random.³⁵ In addition, the Service audits the largest corporations more frequently (sometimes continuously), and they generally must disclose uncertain tax positions and reconcile their book-tax reporting differences, increasing the probability that

& ECON. 291–324 (2015) (finding that corporations gradually *increase* their tax aggressiveness for a few years following an audit and then *reduce* it sharply); NAT'L TAXPAYER ADVOC., 2013 ANNUAL REPORT TO CONGRESS VOL. 2, DO ACCURACY-RELATED PENALTIES IMPROVE FUTURE REPORTING COMPLIANCE BY SCHEDULE C FILERS? 1–14 (finding that Schedule C filers subject to penalties that seemed unfair—those assessed by default, abated, or appealed—appeared to have lower levels of compliance in subsequent years).

³³ See, e.g., Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner's Law and Social Norms*, 36 U. RICH. L. REV. 367 (2002) (discussing studies that found taxpayers who were exposed to information emphasizing the severity of tax-evasion penalties claimed more deductions than similarly situated taxpayers exposed either to a moral appeal or to no information at all).

³⁴ See, e.g., RICHARD THALER, *MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS* (2015) (overview); DAN ARIELY, *PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS* (2008) (overview); DAN ARIELY, *THE HONEST TRUTH ABOUT DISHONESTY: HOW WE LIE TO EVERYONE—ESPECIALLY OURSELVES* (2012) (discussing self-image); DANIEL KAHNEMAN, *THINKING, FAST AND SLOW* (2011) (discussing mental shortcuts); JONAH BERGER, *INVISIBLE INFLUENCE: THE HIDDEN FORCES THAT SHAPE BEHAVIOR* (2016) (discussing norms).

³⁵ See, e.g., Jeffrey Dubin & Louis Wilde, *An Empirical Analysis of Federal Income Tax Auditing and Compliance*, 41 NAT'L TAX J. 61, 71 (1988) (stating that “the IRS seems effectively to direct its resources in these cases to those areas in which compliance is worst”). Perhaps more importantly, taxpayers probably do not expect audit selection to be random. See Jack Manhire, *Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance*, 33 VA. TAX REV. 629, 651 (2014) (observing that “[t]ax compliance decisions consider probabilities of detection conditional on the taxpayer's choice of . . . whether to underreport tax”).

anomalies will be detected.³⁶ Research suggests that increased transparency reduces noncompliance for these businesses.³⁷

Moreover, taxpayers who invest in certain tax-motivated transactions must disclose them, and their advisors cannot take the audit rate into account when providing advice that might help avoid fault-based penalties.³⁸ If these taxpayers cross the line into intentional evasion, they may also face criminal penalties.³⁹ These rules reinforce economic deterrence.

³⁶ Schedules M-1, M-2, and M-3 require corporations and partnerships to reconcile their books with their tax returns, increasing the probability that anomalies will be detected. See I.R.M. 4.10.3.7 (Feb. 26, 2016). Schedule UTP (Uncertain Tax Position Statement) requires large corporations to report uncertain tax positions for which they have a tax reserve on their books or for which no reserve was created because they expect to litigate. INTERNAL REVENUE SERV., INSTRUCTIONS FOR SCHEDULE UTP (FORM 1120) (2016). The Service's continuous audits do not, however, appear to increase compliance of the largest corporations through deterrence. See Benjamin Ayers, Jeri Seidman & Erin Towery, *Taxpayer Behavior Under Audit Certainty* (May 23, 2015) (unpublished), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2609134 [<https://perma.cc/3RBV-3QU5>].

³⁷ See, e.g., Michael Donohoe & Gary McGill, *The Effects of Increased Book-Tax Difference Tax Return Disclosures on Firm Valuation and Behavior*, 33 J. AM. TAX'N ASS'N 35–65 (2011) (analyzing schedule M-3); Akinori Tomohara, Ho Jin Lee & Sangjik Lee, *Did FIN 48 Increase Companies' Tax Payments? Trade-Off Between Disclosure and Tax Burdens*, 44 APPLIED ECON. 4239 (2011) (analyzing Fin 48); Lisa De Simone, Richard Sansing & Jeri Seidman, *When Are Enhanced Relationship Tax Compliance Programs Mutually Beneficial?*, 88 ACCT. REV. 1971–91 (2013) (analyzing incentives in “enhanced relationship” programs that require transparency); Paul Beck & Petro Lisowsky, *Tax Uncertainty and Voluntary Real-Time Audits*, 89 ACCT. REV. 867 (2013) (finding that CAP firms reduced their FIN 48 reserves). The effect of the requirement to disclose uncertain tax positions is not as clear. See, e.g., Kim Honaker & Divesh Sharma, *Has Schedule UTP Dampened Corporate Tax Aggressiveness?*, 157 TAX NOTES (TA) 1087 (Nov. 20, 2017).

³⁸ Section 6707A imposes a 75% penalty on an understatement resulting from a “listed” or “reportable” transaction that was not disclosed in two different filings. Section 6662A applies a 20% penalty to “reportable transaction understatements,” which is increased to 30% for transactions that were not disclosed. Section 6662(d)(2)(C)(ii) provides that the normal exception to penalties for items that have “substantial authority” or that are disclosed and have a “reasonable basis” does not apply to “tax shelters,” which are defined broadly. In analyzing reasonable cause, Regulation section 1.6664-4(f) only permits the Service to consider tax opinions that assume the Service will detect and challenge the item. For a discussion of problems with sections 6707A, 6662A, and related penalties, see, for example, NAT'L TAXPAYER ADVOC., 2008 ANNUAL REPORT TO CONGRESS VOL. 1, MODIFY INTERNAL REVENUE CODE SECTION 6707A TO AMELIORATE UNCONSCIONABLE IMPACT 342–43; AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, *supra* note 15; Toni Robinson & Mary Ferrari, *Congress Eases a Penalty, but Squanders Reform Opportunity*, 130 TAX NOTES (TA) 333 (Jan. 17, 2011).

³⁹ For example, section 7201 provides that

[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000

II. Strict Liability Penalties Trade Fairness for Deterrence

In theory, a strict liability penalty could generate more deterrence than an equivalent fault-based penalty. If noncompliance is detected, in some cases a taxpayer may avoid a penalty if he or she had “reasonable cause” for the violation, for example, because he or she reasonably relied in good faith on the written advice of a qualified tax professional.⁴⁰ This fault-based rule makes the government seem reasonable because it does not set unrealistic expectations—taxpayers are just expected to seek and follow the written advice of qualified tax professionals in good faith. One perceived problem with fault-based rules is that they reduce the penalty’s value as an economic deterrent.

In other words, a fault-based penalty may be less effective as a deterrent because any taxpayer can make the argument that he or she has reasonable cause, increasing the likelihood that a partial penalty or no penalty will apply. Proponents of strict liability penalties argue that they are more effective as a deterrent because they are less likely to be waived than fault-based penalties.⁴¹

A. *Explicit Strict Liability Penalties*

For the reasons described above, in 2010 Congress enacted a strict liability penalty, which applies to understatements resulting from certain transactions that lack “economic substance” (*i.e.*, that do not result in a meaningful change to the taxpayer’s economic position other than a purported reduction in federal income tax).⁴² Nonetheless, some have suggested that when the rules are unclear, moderately severe fault-based penalties can provide better deterrence than strict liability penalties.⁴³ Moreover, critics argue that this

(\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

⁴⁰ See, e.g., I.R.C. § 6664(c); Reg. § 1.6664-4.

⁴¹ See STAFF OF THE JOINT COMM. ON TAX’N, DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2010 BUDGET PROPOSAL 56, 63–65 (Sept. 2009) (citing Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569, 576 (2006)); S. REP. NO. 110-206, at 91–92 (2007)).

⁴² Health Care and Education Reconciliation Act of 2010, 111 Pub. L. No. 152, § 1409, 124 Stat. 1029, 1069 (codified at sections 7701(o) (defining “economic substance”), 6662A (imposing strict liability penalty for reportable transactions), 6662(i) (imposing a 40% strict liability penalty for those that lack economic substance), 6664(d)(3)(B) (strengthening reasonable cause)); see STAFF OF THE JOINT COMM. ON TAX’N, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE “RECONCILIATION ACT OF 2010,” AS AMENDED, IN COMBINATION WITH THE “PATIENT PROTECTION AND AFFORDABLE CARE ACT” 148 (Mar. 21, 2010). Critics of the economic substance penalty have argued there is no justification for singling out transactions that lack economic substance as particularly egregious. See Kathleen Thomas, *The Case Against a Strict Liability Economic Substance Penalty*, 13 U. PA. J. BUS. L. 445 (2011).

⁴³ See Mark P. Gergen, *Uncertainty and Tax Enforcement: A Case for Moderate Fault-Based Penalties*, 64 TAX L. REV. 453 (2010).

penalty fails the criteria established by the Service's task force (*i.e.*, fairness, clarity, effectiveness, and ease of administration).⁴⁴

Some have argued that strict liability penalties are: inherently unfair (*e.g.*, because they apply to those who had reasonable cause for the violation), discourage taxpayers from correcting mistakes or settling disputes, encourage courts to narrow the anti-abuse rules, and discourage legitimate transactions.⁴⁵ Moreover, if a taxpayer can reasonably claim a strict liability penalty is unfair, the penalty may erode trust for the government and the moral authority of the law. By analogy, the criminalization of noncriminal conduct dilutes the stigmatizing effect of a criminal conviction.⁴⁶

If tax penalty laws promote voluntary compliance by educating people about community norms, the law could lose credibility as the voice of the community when it punishes conduct that the community does not consider blameworthy. For example, if the government creates complicated rules and then imposes disproportionate penalties against a layman who reasonably relied on a tax professional's advice in good faith, the government's conduct may be more likely to be viewed as illegitimate and outside the norm than the taxpayer's.

Strict liability penalties also encourage taxpayers to take unreasonable measures that have social costs.⁴⁷ They reduce the incentive for taxpayers to take reasonable precautions (*e.g.*, obtain written tax opinions) or correct mis-

⁴⁴ See, *e.g.*, AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, *supra* note 15; Lawrence M. Hill & Alexandra Minkovich, *Tax Policy Gone Wild: Harsh Penalties as Revenue Raisers*, 115 TAX NOTES (TA) 79 (Apr. 2, 2007).

⁴⁵ See, *e.g.*, STAFF OF THE JOINT COMM. ON TAX'N, DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2010 BUDGET PROPOSAL, PART TWO: BUSINESS TAX PROVISIONS 63–68 (2009) (summarizing arguments for and against the strict liability penalty). For arguments against it, see, for example, AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, *supra* note 15; Hill & Minkovich, *supra* note 44; David S. Miller, *An Alternative to Codification of the Economic Substance Doctrine*, 123 TAX NOTES (TA) 747 (May 11, 2009); Clinton Stretch et al., *Economic Substance and Strict Liability Do Not Mix*, 123 TAX NOTES (TA) 1357 (June 15, 2009). See also ABA Section of Taxation, *ABA Tax Reform & Simplification Project* (2011), <https://www.americanbar.org/content/dam/aba/events/taxation/taxiq-fall11-colvin-taxreformcomments.authcheckdam.pdf> [<https://perma.cc/84G8-JBLK>]; NAT'L TAXPAYER ADVOC., 2008 ANNUAL REPORT, *supra* note 1, at 1-15.

⁴⁶ See Paul H. Robinson & John M. Darley, *The Utility of Desert*, 91 NW. U. L. REV. 453, 481–83 (1997) (discussing, for example, the criminalization of “regulatory” violations and other seemingly trivial acts, such as picking up an eagle's feather to use in a piece of artwork).

⁴⁷ See, *e.g.*, A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law* (Harv. L. Sch. John M. Olin Ctr. Law, Econ. & Bus. Discus. Paper 529, 2005) (explaining how economic theory suggests that fault-based penalties are more efficient than strict liability penalties because they avoid certain social costs).

takes, and provide incentives to conceal questionable positions, contest penalties in court, and avoid legitimate transactions altogether.⁴⁸ For example, the economic substance penalty may discourage taxpayers from undertaking legal transactions, such as conducting business through partnerships or undertaking economic activities for which Congress has provided tax incentives.⁴⁹

By contrast, fault-based penalties reinforce the moral authority of the law by applying only in cases where taxpayers did not take reasonable steps to comply. They provide incentives to use good faith efforts to comply because they reassure taxpayers that those efforts will pay off (*i.e.*, a penalty will not apply so long as there was a reasonable cause for the error and the taxpayer acted in good faith).⁵⁰ They also provide less of an incentive for the parties to waste resources disputing whether a violation exists, at least in cases where the taxpayer acted reasonably and in good faith.

Moreover, with fault-based penalties the Service does not have to waste resources and goodwill detecting and punishing violations in cases where the taxpayer had reasonable cause.⁵¹ It is not put in the uncomfortable position

⁴⁸ See, e.g., Jeremiah Coder, *Achieving Meaningful Civil Tax Penalty Reform and Making It Stick*, 27 AKRON TAX J. 153, 168 (2012).

⁴⁹ See, e.g., AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, *supra* note 15 (“Overbroad penalties that discourage remedial or other good conduct undermine faith in the fairness of the system. This may undercut compliance and transparency or cause taxpayers to forego Congressionally intended benefits to avoid possible missteps and the resulting penalty consequences.”); *New York State Bar Association Submits Comments on Modifications to House Healthcare Bill*, 2009 TAX NOTES TODAY 182-25 (Sept. 23, 2009) (stating that “imposing stiff penalties without allowing taxpayers any opportunity to demonstrate why an exception or waiver of the penalty should apply may have unanticipated consequences and may not be viewed as promoting tax compliance, even with respect to transactions that the Internal Revenue Service considers patently unlawful.”); Stretch et al., *supra* note 45, at 1362 (“In practice . . . many taxpayers considering other entirely legitimate transactions, simply will abandon the transactions until guidance on which they can rely is provided by Treasury or the IRS rather than risk the imposition of a strict liability penalty.”); Hill & Minkovich, *supra* note 44, at 81 (“Risk-averse taxpayers will avoid any transaction that could potentially be challenged as lacking economic substance, even though a review of the transaction might ultimately vindicate the transaction as one that has economic substance.”).

⁵⁰ The flip side of this advantage is that, in theory, a fault-based penalty may still underdeter taxpayers who make decisions based solely on a cost benefit analysis. See Logue, *supra* note 18, at 286–87 (arguing that a fault-based penalty “may result in far too many uncertain (albeit ‘reasonably uncertain’) tax positions being taken”).

⁵¹ See, e.g., Milk Shin-Li, Note, *Strictly Wrong as Tax Policy: The Strict Liability Penalty Standard in Noneconomic Substance Transactions*, 78 FORDHAM L. REV. 2009 (2009) (arguing that a strict liability penalty should not be adopted because it unfairly applies to those who made reasonable good faith efforts to comply with complicated rules; unfair penalties designed to raise revenue may decrease voluntary compliance, increase controversy and reduce cooperation with the Service, and may be less likely to be assessed by agents or upheld by courts).

of either having to lose legitimacy in the eyes of the public by punishing people who acted reasonably and in good faith, or by nullifying or ignoring the rules.⁵²

B. *De Facto Strict Liability Penalties*

Although fault-based penalties are generally fairer and generate fewer social costs than strict liability penalties, they may seem costly to administer because the government must make an individualized determination about whether taxpayers had “reasonable cause” for apparent violations.⁵³ When the government tries to save resources by using automation and presumptions that shift this burden to taxpayers, it can, in effect, turn a fault-based penalty into a strict liability penalty.

For example, the Service’s matching program (called Automated Underreporter or AUR) automatically proposes a “negligence” penalty when the Service finds certain mismatches between the taxpayer’s return and a third party information return (*e.g.*, a Form W-2 or Form 1099) in two or more years,⁵⁴ unless the taxpayer timely responds to the Service’s inquiry by satisfactorily explaining the apparent discrepancy.⁵⁵ The Service does not, however, call taxpayers or consider obvious explanations for mismatches (*e.g.*, transcription errors).⁵⁶ The Service uses a similar process when applying the penalty for

⁵² See Logue, *supra* note 18, at 295 (concluding that if large punitive penalties are impractical or uncollectable, then a fault-based penalty may be superior to a strict liability penalty, particularly if we allow for the possibility that “lower formal penalties would lead to higher informal penalties”).

⁵³ Fault-based penalties could cost less to administer if fewer people contest them than other types of penalties.

⁵⁴ I.R.M. 4.19.3.17.6 (May 19, 2017). There may be some justification for applying higher penalties to repeat offenders and giving a break to first-time offenders. See David A. Dana, *Rethinking the Puzzle of Escalating Penalties for Repeat Offenders*, 110 YALE L.J. 733, 776–77 (2001) (discussing greater internalization of the proper moral conduct as justification for escalating penalties for subsequent offenses, which cannot be justified based on deterrence theory alone). The Service’s process, however, identifies those with repeat mismatches, not necessarily repeat offenses.

⁵⁵ See NAT’L TAXPAYER ADVOC., 2014 ANNUAL REPORT TO CONGRESS VOL. 1, THE IRS DOES NOT ENSURE PENALTIES PROMOTE VOLUNTARY COMPLIANCE, AS RECOMMENDED BY CONGRESS AND OTHERS 94–101; see generally NAT’L TAXPAYER ADVOC., 2008 ANNUAL REPORT, *supra* note 1. See also *IRS Policy Weakens Requirements for Penalties*, NAT’L TAXPAYER ADVOC. BLOG (Oct. 4, 2017), <https://taxpayeradvocate.irs.gov/news/nta-blog-irs-policy-weakens-requirements-for-penalties>; NAT’L TAXPAYER ADVOC., 2007 ANNUAL REPORT TO CONGRESS VOL. 1, THE ACCURACY-RELATED PENALTY IN THE AUTOMATED UNDERREPORTER UNITS 275–86.

⁵⁶ Service data often contains errors. For example, one study found that the Service could have resolved 56% of the TIN mismatches in one of its databases using information already in its possession (*e.g.*, the TIN listed on a prior year’s return). NAT’L TAXPAYER ADVOC., 2011 ANNUAL REPORT TO CONGRESS VOL. 2, MATH ERRORS COMMITTED ON INDIVIDUAL TAX RETURNS—A REVIEW OF MATH ERRORS ISSUED ON CLAIMED DEPENDENTS 114, 119–20. Communications may be particularly challenging for low income taxpayers because they are more likely to have

improperly claimed credits, including the Earned Income Tax Credit.⁵⁷ Taxpayers who made reasonable attempts to comply must take extra burdensome steps to avoid a penalty. For those who do not or cannot—often the lowest income taxpayers—the penalty applies. In effect, they face a strict liability penalty for failing to respond to the Service’s notice or for failing to explain the mismatch.⁵⁸

C. Research Suggests These Penalties Can Reduce Compliance

Although strict liability penalties are supposed to strengthen deterrence, available evidence suggests that accuracy-related penalties do not improve reporting compliance among Schedule C filers when assessed by default.⁵⁹ A study of Schedule C filers found that taxpayers subject to default penalty assessments appeared *less* compliant five years later than those not subject to penalties.⁶⁰ The study suggested that penalties assessed by default may undermine voluntary compliance because they are viewed as unfair.⁶¹ To avoid damaging voluntary compliance, the Service should ensure that automation and presumptions do not convert a reasonable fault-based penalty into a strict

limited English proficiency, low literacy rates, physical or mental disabilities, lower education levels, limited access to the internet, and limited access to qualified tax professionals. See NAT’L TAXPAYER ADVOC., 2009 ANNUAL REPORT TO CONGRESS VOL. 1, THE NEEDS OF LOW INCOME TAXPAYERS ARE NOT BEING ADEQUATELY MET 112–13.

⁵⁷ See, e.g., NAT’L TAXPAYER ADVOC., 2013 ANNUAL REPORT TO CONGRESS VOL. 1, THE IRS ASSESSED PENALTIES IMPROPERLY, REFUSED TO ABATE THEM, AND STILL ASSESSES PENALTIES AUTOMATICALLY 182 (discussing the Service’s use of the accuracy-related penalties for credit claims); *id.* at 108 (THE IRS INAPPROPRIATELY BANS MANY TAXPAYERS FROM CLAIMING EITC) (discussing the “penalty” for improperly claiming the Earned Income Tax Credit (EITC) (*i.e.*, the two-year ban)); NAT’L TAXPAYER ADVOC., 2013 ANNUAL REPORT TO CONGRESS VOL. 1, ALLOCATE TO THE IRS THE BURDEN OF PROVING IT PROPERLY IMPOSED THE TWO-YEAR BAN ON CLAIMING THE EARNED INCOME TAX CREDIT 311.

⁵⁸ Although section 7491(c) sometimes shifts the burden of production to the Service, taxpayers generally have the burden to prove reasonable cause. S. REP. NO. 105-174, at 46 (1998); Higbee v. Commissioner, 116 T.C. 438 (2001). Some have argued that this makes sense because taxpayers have the relevant information and otherwise the audit process would become more intrusive. See Steve Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 IOWA L. REV. 413 (1999).

⁵⁹ See NAT’L TAXPAYER ADVOC., 2013 ANNUAL REPORT, *supra* note 32, at 3.

⁶⁰ See *id.*

⁶¹ Penalizing people by default in the interests of efficiency may offend notions of fairness that are embedded in the U.S. constitution. See, e.g., *Stanley v. Illinois*, 405 U.S. 645, 656–57 (1972) (“[O]ne might fairly say of the Bill of Rights in general, and the Due Process Clause in particular, that they were designed to protect the fragile values of a vulnerable citizenry from the overbearing concern for efficiency and efficacy that may characterize praiseworthy government officials no less, and perhaps more, than mediocre ones. Procedure by presumption is always cheaper and easier than individualized determination.”).

liability penalty, particularly one that has a disparate impact on low income taxpayers.

D. *Alternatives to Strict Liability Penalties*

Strict liability penalties are not the only way to provide additional deterrence. There are reasonable alternatives, such as to raise the likelihood of detection, require taxpayers to take specific steps to establish they were not at fault, raise the fault-based penalty rate, or apply a nonmonetary penalty such as public shaming.⁶²

III. Nonmonetary Penalties Trade Fairness and Social Costs for Deterrence

In certain jurisdictions, civil tax noncompliance can result in nonmonetary penalties (*i.e.*, penalties other than fines).⁶³ Nonmonetary penalties are generally more visible than confidential fines. For example, tax delinquencies can result in the public disclosure of a person's name and address, the loss or denial of government benefits such as a driver's license, auto registration, liquor license, professional license, hunting or fishing permit, government contract, government-backed loan, or U.S. passport.⁶⁴ Intentional violations can

⁶² Current law applies each of these approaches in addition to strict liability, rather than in lieu of it. *See, e.g.*, I.R.C. §§ 6662A(c) (applying a higher 30 percent penalty to undisclosed reportable transaction understatements), 6664(d) (limiting the advice upon which taxpayers may rely for purposes of establishing reasonable cause to avoid penalties on reportable transaction understatements), 6707A(e) (requiring certain publicly traded companies to disclose certain penalties in their public filings).

⁶³ Of course, a nonmonetary sanction will often have economic effects.

⁶⁴ *See, e.g., Frequently Asked Questions, Suspension of Licenses*, LOUISIANA DEPARTMENT OF REVENUE, <http://www.rev.state.la.us/FAQ/QuestionsAndAnswers/51> [<https://perma.cc/W7VH-5QE7>] (last visited March 25, 2019) (hunting and driver's licenses); *Top 500 Delinquent Taxpayers*, CALIFORNIA FRANCHISE TAX BOARD (FTB) <https://www.ftb.ca.gov/aboutftb/delinquent-taxpayers.shtml> [<https://perma.cc/636M-ZVF4>] (last visited Mar. 25, 2019) (public disclosure; occupational, professional, and drivers licenses; and government contracts); I.R.C. § 7345 (U.S. passports); Consolidated and Further Continuing Appropriations Act of 2012, Pub. L. No. 112-55, § 527, 125 Stat 636 (2011) (government contracts); Minn. Stat. § 270C.72 (2016) (medical license); Minn. Stat. § 270C.725 (2016) (liquor license). *See also Published Details of Deliberate Tax Defaulters*, HER MAJESTY'S REVENUE AND CUSTOMS (HMRC), U.K., <https://www.gov.uk/government/publications/publishing-details-of-deliberate-tax-defaulters-pddd> [<https://perma.cc/U5CZ-Z9SM>] (last updated Mar. 11, 2019) (public disclosure). OFFICE OF MGMT. & BUDGET (OMB), EXEC. OFFICE OF THE PRESIDENT, CIRCULAR A-129: POLICIES FOR FEDERAL CREDIT PROGRAMS AND NON-TAX RECEIVABLES, Appendix A § III (A)(1)(b) (Jan. 2013) (government loans denied to those with delinquent tax debts). Proposed legislation would also render individuals with seriously delinquent tax debt ineligible for federal civilian employment, contracts, or grants. *See, e.g.*, Tax Accountability Act of 2017, H.R. 396, 115th Cong. (2017). Beginning in 2015, individuals who owe more than \$50,000 (increased annually for inflation) in federal taxes may

even result in deportation.⁶⁵ Nonmonetary penalties have certain advantages and disadvantages.

A. *Advantages of Nonmonetary Penalties*

1. *Nonmonetary Penalties Can Provide Incentives for Those With Both High and Low Incomes*

One feature of nonmonetary penalties is that they can be imposed against—and potentially deter noncompliance by—those from whom a monetary penalty could not be collected (*e.g.*, low income taxpayers). While this may seem regressive, nonmonetary penalties can be more progressive and tailored than flat-rate monetary penalties if wealthier individuals and businesses have more to lose when their government-granted privileges are denied or revoked, or when their reputations are tarnished (*e.g.*, those who use a license or their reputation to earn more money suffer greater losses when it is revoked or tarnished, respectively).⁶⁶ Of course, a fine could also be structured to be progressive, but then it would be more complicated, potentially diluting its salience and effectiveness.

2. *Nonmonetary Penalties Can Leverage Noneconomic Factors*

Nonmonetary penalties could be more effective because of their impact on noneconomic factors, such as: salience, the endowment effect, signaling, social norms, and reciprocity.⁶⁷ For example, behavioral economics suggests that people are more likely to act on information that is prominent or salient. For instance, they are more likely to report correctly when they swear to do so at the beginning of a form instead of at the end because doing so is more

have their passports revoked by the U.S. State Department. Fixing America's Surface Transportation (FAST) Act, Pub. L. No. 114-94, § 32101, 129 Stat. 1312, 1729–33 (2015) (codified at section 7345). Some have argued that the Service's implementation of this rule does not provide sufficient taxpayer protections. *See, e.g.*, NAT'L TAXPAYER ADVOC., 2018 OBJECTIVES REPORT TO CONGRESS VOL. 1, THE IRS'S CERTIFICATION PROGRAM RELATED TO DENIAL OR REVOCATION OF PASSPORTS IMPAIRS TAXPAYER RIGHTS (2017); Texas Society of Certified Public Accountants, *TSCPA Asks IRS To Fine-Tune Passport Revocation Procedures*, 2017 TAX NOTES TODAY 46-12 (Mar. 10, 2017).

⁶⁵ *Kawashima v. Holder*, 565 U.S. 478 (2012) (holding that a conviction for tax evasion may qualify as an aggravated felony for which a lawful permanent resident may be deported).

⁶⁶ *See* Yulia Paramonova, *Collateral Tax Sanctions: A Way to Correlate Punishment with Ability*, in NAT'L TAX ASSOC. 108TH ANNUAL CONF. PROC. (Apr. 29, 2015) (arguing nonmonetary penalties can increase social welfare by imposing costs that correlate with earning potential).

⁶⁷ *See* Joshua D. Blank, *Collateral Compliance*, 162 U. PA. L. REV. 720, 726–27 (2014) (discussing the utility of nonmonetary penalties in light of various behavioral insights). For a survey of tax-related behavioral insights, *see, for example*, NAT'L TAXPAYER ADVOC., 2016 ANNUAL REPORT TO CONGRESS VOL. 3, BEHAVIORAL SCIENCE LESSONS FOR TAXPAYER COMPLIANCE 44. For the meaning of salience, *see supra* note 14.

likely to get their attention.⁶⁸ Similarly, nonmonetary penalties (*e.g.*, losing your license or reputation) are probably more attention-grabbing than monetary penalties, which are simply added to the total tax debt.

Behavioral scientists have also discovered the endowment effect—that people will often pay more to keep what they have than to purchase it.⁶⁹ Thus, the prospect of losing a person's reputation or government-granted privilege may provide a stronger incentive than a monetary penalty of equivalent value.

Nonmonetary penalties can also improve compliance via signaling, shaming, and reputational effects. Although monetary penalties are generally not public knowledge, nonmonetary penalties can be visible enough to send signals to peers, family, friends, and customers, triggering a reputational penalty and shaming the violator.⁷⁰

Along the same lines, research suggests that people generally follow social norms by mirroring the behavior of others.⁷¹ If people believe that noncompliance is punished, they may infer that most others comply, and reciprocate by complying.⁷² Thus, the greater visibility of nonmonetary penalties could

⁶⁸ See, *e.g.*, Lisa L. Shu et al., *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. OF THE NAT'L ACAD. OF SCI. 15197 (2012), <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3458378/> [<https://pema.cc/333T-GCL8>].

⁶⁹ See, *e.g.*, Kahneman et al., *supra* note 17.

⁷⁰ See generally Posner, *supra* note 12; Eric A. Posner, *The Signaling Model of Social Norms: Further Thoughts*, 36 U. MICH. L. REV. 465 (2002). To the extent penalties serve as a signal, however, they could undermine compliance by crowding out reciprocity and other intrinsic motives. See Kahan, *supra* note 33.

⁷¹ See, *e.g.*, OECD, UNDERSTANDING AND INFLUENCING TAXPAYERS' COMPLIANCE BEHAVIOR 21 (2010) (indicating that social norms—what taxpayers believe their peers normally do—are the most important noneconomic factor affecting tax compliance); BEHAVIORAL INSIGHTS TEAM, UPDATE REPORT 2013–2015, 16, 35–36, 44 (2015) (finding that messages emphasizing that most people pay their taxes had a significant return on investment); Kettle et al., *supra* note 10 (same); John Hasseldine et al., *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 CONTEMP. ACCOUNTING RES. 171 (2007) (same).

⁷² See, *e.g.*, Kahan, *supra* note 33 (suggesting on the one hand that the most effective means to promote cooperative behavior is to promote trust—the shared beliefs that others can, in fact, be counted on to contribute their fair share to public goods, whether or not doing so is in their material self-interest—but cautioning that incentives can often backfire by implying that most individuals are not inclined to contribute to collective goods voluntarily); Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71, 72 (2003) (same). Although the effect of the sanction on the person receiving it may be perceived as controlling, it may support compliance by others. See, *e.g.*, S. Frey & Reto Jegen, *Motivation Crowding Theory: A Survey of Empirical Evidence* 7 (CESifo Group, Working Paper No. 245, 2000) (finding that external interventions crowd-out intrinsic motivation if they are perceived as controlling, but crowd-in intrinsic motivation if perceived as supportive); Frey & Feld, *supra* note 24 (same).

support compliance norms. On the other hand, the constant drip of revelations of noncompliance by others could reduce compliance if it leaves the impression that noncompliance is the norm.⁷³

3. *Nonmonetary Penalties Can Change Preferences and Reinforce Tax Morale*

All penalties provide extrinsic motivations to comply that could crowd-out intrinsic motivations.⁷⁴ Nonmonetary penalties, however, may be less likely to do so than monetary penalties. Studies show that people are less likely to consider their altruistic motives when decisions are framed in terms of money.⁷⁵ As an example, introducing a fine for late daycare pickups increased late pickups, perhaps because the fine removed intrinsic motivations (e.g., guilt).⁷⁶

Along the same lines, when taxpayers are reminded that they receive public services they may also be more likely to feel guilty when they do not comply.⁷⁷ Thus, if the penalty for noncompliance involves taking away the taxpayer's public benefit, it could reinforce this linkage between services and compliance.⁷⁸

⁷³ See, e.g., Steven Sheffrin & Robert Triest, *Can Brute Deterrence Backfire? Perceptions and Attitudes in Taxpayer Compliance*, in *WHY PEOPLE PAY TAXES* (Joel Slemrod ed., 1992) (observing that those who read about compliance problems were less likely to comply).

⁷⁴ For a discussion of the crowding-out effect, see, for example, James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 *J. ECON. PSYCHOL.* 224, 228–29 (2006); Frey & Feld, *supra* note 24 (arguing that “authoritarian” government approach may “crowd out” compliance based on tax morale but that a “respectful” government approach may “crowd in” such compliance).

⁷⁵ See, e.g., James Heyman & Dan Ariely, *Effort for Payment: A Tale of Two Markets*, 15 *PSYCHOL. SCI.* 787, 792–93 (2004) (finding that when “payments were given in the form of gifts (candy) or when payments were not mentioned, effort seemed to stem from altruistic motives and was largely insensitive to the magnitude of the payment. In contrast, when payments were given in the form of cash, effort seemed to stem from reciprocation motives and was sensitive to the magnitude of the payment.”).

⁷⁶ See Uri Gneezy & Aldo Rustichini, *A Fine is a Price*, 29 *J. LEGAL STUD.* 1 (2000) (introducing a fine for late daycare pickups increased late pickups). See also James Heyman & Dan Ariely, *supra* note 75, at 792–93 (2004) (suggesting that because people sometimes expend more effort in exchange for no payment (a social market) than when they receive low payment (a monetary market), adding monetary incentives can reduce those efforts). Experiments suggest that reminders of money (relative to nonmonetary reminders) tend to reduce helpfulness toward others. See Kathleen D. Vohs, Nicole L. Mead & Miranda R. Goode, *The Psychological Consequences of Money*, 314 *SCI.* 1154 (2006).

⁷⁷ See, e.g., Lars P. Feld & Bruno S. Frey, *Tax Evasion and the Psychological Tax Contract*, in *DEVELOPING ALTERNATIVE FRAMEWORKS*, *supra* note 7, at 88 (suggesting that tax morale is a function of public services, the political process, and the person's relationship with the tax administrator); James Alm & Benno Torgler, *Culture Differences and Tax Morale in the United States and in Europe*, 27 *J. ECON. PSYCHOL.* 224, 228–29 (2006).

⁷⁸ See Blank, *supra* note 67, at 794–99.

Nonmonetary penalties may also do a better job of expressing society's moral condemnation of tax violations, reinforcing tax morale. As one scholar has explained:

[i]mprisonment unmistakably expresses moral indignation because of the sacred place of liberty in our culture . . . [By contrast,] fines seem to say that offenders may buy the privilege of breaking the law; and we can't very well condemn someone for purchasing what we are willing to sell.⁷⁹

Public shaming (including incarceration) is especially effective in expressing society's moral condemnation, which can shape a taxpayer's intrinsic compliance preferences.⁸⁰ Shaming may also improve compliance by businesses whose compliance decisions are based on a cost-benefit analysis. Such businesses are likely to care about the opinion of their stakeholders (*i.e.*, owners, customers, employees, and trading partners), even if they are less likely than individuals to have guilt or other intrinsic motives to comply.⁸¹ If their stakeholders disapprove of noncompliance or its risks, the businesses could be strongly motivated to avoid any penalties that involve public disclosure of noncompliance or shaming.

Moreover, empirical evidence suggests that public disclosure can be effective in changing behavior. For example, when the government in Norway first published its paper lists of taxpayers with tax delinquencies on the Inter-

⁷⁹ See Dan M. Kahan, *Social Meaning and the Economic Analysis of Crime*, 27 J. LEGAL STUD. 609, 616 (1998). See also Massimo D'Antoni & Roberto Galbiati, *A Signaling Theory of Non-monetary Sanctions*, 27 INT'L REV. L. & ECON. 204–18 (2007), https://ac.els-cdn.com/S0144818807000555/1-s2.0-S0144818807000555-MAIN.PDF?_TID=41c920ce-a3b2-4e91-a697-c25f6ee79bad&acdnat=1552603654_1cb0f75684c143cdd44f9422ec955958 [<https://perm.a.cc/A27W-ECTV>] (explaining that unlike monetary penalties, which can be imposed to raise revenue (rather than to prevent real harm to society) nonmonetary penalties communicate that the sanctioned behavior is harmful and signal the government's commitment to reducing it); Yoram Keinan, *Playing the Audit Lottery: The Role of Penalties in the U.S. Tax Law in the Aftermath of Long Term Capital Holdings v. United States*, 3 BERKELEY BUS. L.J. 381, 391–92 (2006) (“If a fine is considered to be equivalent to a tax, the bad man's point of view removes any distinction between wrongful conduct, which should be followed by a sanction and acceptable conduct which is taxed.”).

⁸⁰ See, *e.g.*, Carol S. Steiker, *Punishment and Procedure: Punishment Theory and the Criminal-Civil Procedural Divide*, 85 GEO. L.J. 775, 808 (1997). Perhaps because preference shaping is beneficial when a person intended to violate a rule, criminal punishments typically require a showing of intent, may apply in cases of attempted wrongdoing (*i.e.*, where there is no harm), and vary based on the characteristics of the individual offender. See Kenneth G. Dau-Schmidt, *An Economic Analysis of the Law as a Preference-Shaping Policy*, 1990 DUKE L.J. 1, 2 (1990).

⁸¹ See, *e.g.*, Keinan, *supra* note 79, at 394 (opining “it is highly unlikely that corporations and their managers consider social norms when making tax-related decisions.”). Perhaps for this reason, certain publicly traded corporations are already subject to shaming, as they must report certain penalties to the public. See I.R.C. § 6707A(e); Rev. Proc. 2005-51, 2005-2 C.B. 296.

net, reported income increased by approximately three percent among business owners living in areas where the switch to Internet disclosure represented a large change in access.⁸² Similarly, individuals and businesses in Japan appeared to increase their underreporting to avoid public disclosure of their tax information.⁸³ A naming-and-shaming policy in Slovenia aimed at reducing outstanding tax debt among businesses prompted 8.5% to pay.⁸⁴ Thus, at least in some cultures, a nonmonetary penalty could do a better job than a monetary penalty of shaping and reinforcing compliance norms, tax morale, and other intrinsic motivations instead of crowding them out, particularly in situations where a proportionate, confidential monetary penalty is ineffective. It is not clear if they would have the same effect in cultures where the tax agency is not trusted or where noncompliance is the norm.

B. *Disadvantages of Nonmonetary Penalties*

In theory, nonmonetary penalties—especially shaming—could be an effective substitute for disproportionate monetary penalties if they incorporate procedural protections to ensure they are viewed as fair. Nonetheless, nonmonetary penalties have significant disadvantages.

1. *Nonmonetary Penalties Are Less Widely Known*

Although most people know that tax cheating can result in monetary penalties and possible imprisonment, they are less likely to know that it can trigger other penalties or consequences.⁸⁵ In some cases, the government may not publicize the consequences (*e.g.*, ineligibility for certain jobs) because they

⁸² Erlend Bø, Joel Slemrod & Thor Thoresen, *Taxes on the Internet: Deterrent Effects of Public Disclosure*, 7 AM. ECON. J. ECON. POL'Y 36 (2015). For the same reasons, one study recommended limited public disclosure of individual tax violations in Australia. Ken Devos & Marcus Zackrisson, *Tax Compliance and the Public Disclosure of Tax Information—An Australia-Norway Comparison*, 13 E-J. TAX RES. 108, 226 (2015), https://www.business.unsw.edu.au/research-site/publications-site/ejournaloftaxresearch-site/Documents/eJTR_Vol13_No1_2015.pdf#page=108 [<https://perma.cc/8SEN-CP7L>].

⁸³ Makoto Hasegawa et al., *The Effect of Public Disclosure on Reported Taxable Income: Evidence from Individuals and Corporations in Japan*, 66 NAT'L TAX J. 571–608 (2013) (finding that both individual and corporate taxpayers whose tax liability would otherwise be close to a threshold that would trigger public disclosure of their tax information underreported to avoid disclosure).

⁸⁴ Nadja Dwengera & Lukas Treberb, *Shaming for Tax Enforcement: Evidence from a New Policy* (Univ. Hohenheim, CEPR Discussion Paper, Aug. 4, 2018).

⁸⁵ See, *e.g.*, Michael Pinard, *An Integrated Perspective on the Collateral Consequences of Criminal Convictions and Reentry Issues Faced by Formerly Incarcerated Individuals*, 86 B.U. L. REV. 623, 639 (2006) (“[E]ven institutional actors such as judges, prosecutors, and defense attorneys are often unaware of the array of consequences that can attach to a criminal conviction.”).

are not intended to deter violations. Rather, the government may not want to give positions of power and trust to those who have broken the law.⁸⁶

Similarly, although the Service generally discloses the possibility that non-compliance could result in enforcement activity that becomes public (such as the filing of a notice of federal tax lien (NFTL)), this type of shaming is not framed to emphasize that business associates, colleagues, friends, and family may learn about the delinquency.⁸⁷ It is, however, difficult for penalties to affect the behavior of those who do not know about or understand them.⁸⁸

Luckily, nonmonetary penalties should be relatively easy to publicize because they are remarkable. Moreover, public shaming is perhaps uniquely easy to publicize because the shaming itself can create its own publicity, at least when the shaming process is novel or the people involved are noteworthy.

2. *Nonmonetary Penalties Can Impose Social Costs*

Economic theory suggests that in most cases, monetary penalties are superior to nonmonetary penalties, at least when they can be collected and are set high enough to deter violations.⁸⁹ For example, incarceration is inferior to

⁸⁶ See, e.g., 5 C.F.R. § 731.202(b)(2) (indicating that “criminal or dishonest” conduct can result in a determination that an individual is not suitable for positions requiring public trust); AM. BAR ASSOC., MODEL RULE FOR LAWYER DISCIPLINARY ENFORCEMENT 19(D)(1) (“The court shall place a lawyer on interim suspension immediately upon proof that the lawyer has been found guilty of a serious crime regardless of the pendency of any appeal.”).

⁸⁷ See, e.g., INTERNAL REVENUE SERV., NOTICE LT39 (“We can file a Notice of Federal Tax Lien on your property at any time to protect the government’s interests. The lien attaches to your current assets and to any assets you acquire in the future. A Notice of Federal Tax Lien will appear on your credit report and can affect your credit rating.”). A NFTL might be more effective as a shaming penalty if it were posted to the internet in a searchable form. Because such public shaming would probably do more damage to a taxpayer’s reputation than a relatively obscure NFTL filing, it would make sense to provide the taxpayer with additional due process before doing more to publicize the filing.

⁸⁸ The Service may have an opportunity to improve compliance by publicizing nonmonetary penalties and consequences. Neither the Service website nor the relevant tax forms or instructions warn that tax noncompliance may result in deportation from the United States for noncitizens or the suspension of medical or law licenses by state licensing agencies. See INTERNAL REVENUE SERV., FORM 1040 INSTRUCTIONS: U.S. INDIVIDUAL INCOME TAX RETURN (2017); INTERNAL REVENUE SERV., NOTICE 746, INFORMATION ABOUT YOUR NOTICE, PENALTY AND INTEREST (2018). The Service website informs taxpayers that the Service may send lists of those with seriously delinquent tax debts to the U.S. State Department so that it may deny or revoke their passports. This information does not, however, appear in the instructions for Form 1040 or Notice 746, which discusses penalties. *Id.*

⁸⁹ See, e.g., Becker, *supra* note 4; Richard A. Posner, *Optimal Sentences for White-Collar Criminals*, 17 AM. CRIM. L. REV. 409 (1980); A. Mitchell Polinsky & Steven Shavell, *Optimal Use of Fines and Imprisonment*, 26 J. PUB. ECON. 89, 98 (1984); James Andreoni, *IRS as Loan Shark—Tax Compliance with Borrowing Constraints*, 49 J. PUB. ECON. 41 (1992). See also Polinsky & Shavell, *supra* note 47, at 15; Stephen G. Bene, *Why Not Fine Attorneys?: An Economic*

finances because it cannot be used to compensate the victim or society and has a social cost, such as the costs of proving the violation beyond a reasonable doubt, the cost of prisons, and the loss of the violator's contributions to the economy (e.g., by providing services and generating tax receipts).⁹⁰

Most other nonmonetary penalties probably have social costs as well. For example, a NFTL results in the public disclosure of a person's tax debt, which is a nonmonetary penalty. The Service sometimes withdraws NFTLs because doing so is in its best interest when the withdrawal helps the debtor earn income to pay both current and future tax liabilities.⁹¹ In other words, it avoids social costs.

Similarly, tarnishing a businessperson's reputation or revoking a professional's license for a tax delinquency involves social costs. It may deprive society of the services of an otherwise qualified professional or business, while also potentially impairing his or her ability to earn a living and pay taxes.

We could minimize the social cost of penalties by structuring them to prevent noncompliance (rather than to punish) and by coupling them with effective settlement programs to change industry norms. For example, if taxpayers knew they had to obtain a tax compliance certificate before they could obtain or renew state and local licenses to operate cash businesses, those unwilling to make the investment in tax compliance might be less likely to enter the business and apply for the license.⁹² In such industries, tax compliance might become the norm, reducing the need for penalties of any kind. Taxpayers would not need to cheat to be competitive. When a business loses its license due to tax noncompliance, it would not be a surprise, and the business might also face a social stigma if compliance were the norm.

The key to avoiding social costs is to provide taxpayers with a realistic option to come into compliance so that they can enter the industry and continue

Approach to Lawyer Disciplinary Sanctions, 43 STAN. L. REV. 907 (1991) (arguing based on economic theory that the ABA and most courts are wrong in rejecting fines as a sanction for misconduct by attorneys and other professionals). Some scholars use many of the same arguments to conclude that it is inefficient to apply criminal sanctions to corporations. See, e.g., Daniel R. Fischel & Alan O. Sykes, *Corporate Crime*, 25 J. LEGAL STUD. 319 (1996); V. S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477 (1996).

⁹⁰ For a more detailed discussion of these costs, see, for example, Deborah N. Archer & Kele S. Williams, *Making America "The Land of Second Chances: Restoring Socioeconomic Rights for Ex-Offenders*, 30 N.Y.U. REV. L. & SOC. CHANGE 527 (2006) (discussing how collateral consequences can prevent ex-offenders from earning a living, encourage recidivism, and burden the state with additional costs for public health, child welfare, public safety, and criminal justice).

⁹¹ Program Manager Technical Advice (PMTA) 2009-158 (Oct. 8, 2009) ("[Lien] withdrawal can be said to be in the United States' best interests insofar as the improvement in the taxpayer's credit history assists him with future tax compliance.").

⁹² See NAT'L TAXPAYER ADVOC., 2007 ANNUAL REPORT, *supra* note 12, A COMPREHENSIVE STRATEGY FOR ADDRESSING THE CASH ECONOMY 18 (recommending the Service work with state and local governments to make federal tax compliance a prerequisite for obtaining or renewing a license, provided there are appropriate exceptions).

operating after a slip-up (e.g., a robust settlement or Offer in Compromise program).⁹³ Only those unwilling to make reasonable efforts to resolve tax delinquencies would be subject to the penalty (i.e., denied a license), and the existence of a fair settlement program would reinforce the impression that the tax system is fair and that ongoing noncompliance is outside the norm.

3. *Nonmonetary Penalties Risk Being Viewed as Unfair*

Although both monetary and nonmonetary penalties risk being viewed as unfair, the risk may be greater for nonmonetary penalties. If one taxpayer uses a government benefit (e.g., a license) and another does not, then punishing them both by taking away a benefit that only harms one of them is likely to seem unfair.

In addition, nonmonetary penalties are more likely to be viewed as unfair than monetary penalties in jurisdictions where they are not the norm. By analogy, when analyzing whether criminal penalties are so disproportionate as to violate the Eighth Amendment's proscription against cruel and unusual punishment, courts consider whether the penalty is in line with norms (e.g., by looking at the sanctions applied by the same jurisdiction for more and less serious offenses, and the sanctions applied by other U.S. jurisdictions for the same offense).⁹⁴ Thus, nonmonetary penalties should be phased in slowly.

Nonmonetary penalties are also perhaps most likely to be viewed as unfair if they infringe basic liberties, such as the right to travel.⁹⁵ Thus, it is particularly important to establish procedural protections to ensure nonmonetary penalties are not applied to innocent taxpayers. Because taxpayers tend to be more hostile to improper penalization than to improper leniency, the agency is most likely to be viewed as fair if it errs on the side of leniency.⁹⁶

⁹³ For a discussion of when to implement and how to structure a settlement program, see NAT'L TAXPAYER ADVOC., 2017 ANNUAL REPORT, *supra* note 13, AN ANALYSIS OF TAX SETTLEMENT PROGRAMS AS AMNESTIES 209–28.

⁹⁴ *See, e.g.,* *Solem v. Helm*, 463 U.S. 277, 292 (1983) (“[A] court’s proportionality analysis under the Eighth Amendment should be guided by objective criteria, including (i) the gravity of the offense and the harshness of the penalty; (ii) the sentences imposed on other criminals in the same jurisdiction; and (iii) the sentences imposed for commission of the same crime in other jurisdictions.”).

⁹⁵ *See* I.R.C. § 7345 (denying U.S. passports to those with seriously delinquent tax debts).

⁹⁶ Thomas Hoffman, *Studies of The Code’s Tax Penalty Structure: A Fitful Step Toward Reform*, 43 TAX LAW. 201, 211 (1989) (“Because taxpayers tend to be more hostile to improper penalization than to an ‘exhibition of leniency,’ the report noted that ‘everyday realities’ of tax administration mandate a degree of leniency in any situation.”) (footnotes omitted).

IV. Procedural Protections Trade Deterrence for Fairness, Trust, and the “Moral Force” of the Law

As noted above, laws are more likely to be viewed as fair, upheld as Constitutional, and obeyed if they are consistent with pre-existing legal and social norms.⁹⁷ It is not uncommon for reasonable and proportionate monetary penalties to be assessed without extensive procedural protections.⁹⁸ Before imposing more severe penalties or penalties that impinge fundamental rights (e.g., liberty, the right to travel, or a person’s reputation), however, governments in the U.S. normally provide the accused with significant procedural protections.⁹⁹ Such protections may help to mitigate some of the problems with penalties.¹⁰⁰

For example, the Due Process Clause, which incorporates the right to fundamental fairness, requires the government to prove a crime “beyond a reasonable doubt.”¹⁰¹ The Supreme Court explained that a criminal conviction will “stigmatize” the accused.¹⁰² This burden of proof is the norm in the U.S. for allegations of criminal conduct because it is necessary for the verdict to

⁹⁷ Scholars have observed that laws are much more effective when they incorporate and reinforce pre-existing social norms. See, e.g., Hayden Windrow, *A Short History of Law, Norms, and Social Control in Imperial China*, 7 *ASIAN-PAC. L. & POL’Y J.* 244, 301 (2006) (“Rather than simply enforcing an arbitrary set of government-defined laws, the codes [in ancient China] reflected already pervasive beliefs, providing legal enforcement with powerful social legitimacy. Members of society that held positions of relative power over others gained an interest in maintaining the socio-political system, since convention and law had become one.”).

⁹⁸ See, e.g., I.R.C. § 6657 (imposing an assessable penalty of up to two percent for bad checks not resulting from reasonable cause).

⁹⁹ See, e.g., *Kent v. Dulles*, 357 U.S. 116, 125 (1958) (“The right to travel is a part of the ‘liberty’ of which the citizen cannot be deprived without due process of law under the Fifth Amendment.”); Universal Declaration of Human Rights, G.A. Res. 217 (III)A, U.N. Doc. A/RES/217(III) at 71 (Dec. 10, 1948) (“Everyone has the right to life, liberty and security of person Everyone has the right to leave any country, including his own, and to return to his country No one shall be subjected to arbitrary interference with his privacy . . . nor to attacks upon his honor and reputation”). I.R.C. § 7345 (requiring the assessment to exceed \$50,000, the Service to have filed a notice of federal tax lien or levy, the taxpayer to have been given the opportunity for a hearing, and that the taxpayer has not compromised, and is not paying in installments, before the Service may pursue passport revocation).

¹⁰⁰ Notably, however, taxpayers do not have the right to judicial review of “assessable” penalties before paying them. See, e.g., *Smith v. Commissioner*, 133 T.C. 424 (2009) (holding that section 6707A penalties were not subject to judicial review by the Tax Court); *Larson v. United States*, 2018 US App. Lexis 10418, 2018 WL 1936354 (2nd Cir. 2018) (penalties under section 6707 are assessable); I.R.C. § 6694(c) (requiring a 15% payment to trigger judicial review of certain preparer penalties); I.R.C. § 6703(c) (same). For recommendations to address this problem, see NAT’L TAXPAYER ADVOC., 2018 ANNUAL REPORT TO CONGRESS VOL. 1, GIVE TAXPAYERS WHO CANNOT PAY THE SAME ACCESS TO JUDICIAL REVIEW AS THOSE WHO CAN 364–86.

¹⁰¹ *In re Winship*, 397 U.S. 358 (1970).

¹⁰² *Id.* at 363–64.

“command the respect and confidence of the community,” and to avoid diluting the “moral force” of the law with “a standard of proof which leaves people in doubt whether innocent men are being condemned.”¹⁰³

Although the government does not bear the same burden in civil cases, it typically must prove civil allegations of “fraud or some other quasi-criminal wrongdoing” by “clear and convincing” evidence, rather than by a mere “preponderance” of the evidence.¹⁰⁴ This higher burden is supposed to “reduce the risk to the defendant of having his reputation tarnished erroneously.”¹⁰⁵

For the same reason, when nonmonetary penalties are adopted to shame or stigmatize, the accused normally has significant procedural protections. If no such protections are adopted, those who are supposed to be shamed can reasonably claim the penalty is unjustified. In such cases, the penalty may be less effective in shaming the accused and more likely to damage the agency’s credibility and legitimacy instead.¹⁰⁶

Because the taxpayer typically has more information than the government about what should appear on his or her return, it can be particularly difficult for the government to prove tax violations.¹⁰⁷ Although the U.S. government sometimes has the burden to produce evidence that a penalty should apply,¹⁰⁸ requiring the government to show that the taxpayer had no reasonable cause (or otherwise increasing its burden of proof) could make examinations overly burdensome.¹⁰⁹ Thus, in lieu of increasing the government’s burden of proof,

¹⁰³ *Id.* at 364. See also Robinson & Darley, *supra* note 46, at 498 (“[W]e have argued that people obey the law not so much because they are fearful of being apprehended by the criminal justice system, but because they care about what their social group thinks of them and because they regard obedience as morally appropriate. Criminal laws based on community standards of deserved punishment enhance this obedience. We conclude that desert distribution of liability happens to be the distribution that has the greatest utility, in the sense of avoiding crime.”).

¹⁰⁴ *Addington v. Texas*, 441 U.S. 418, 424 (1979).

¹⁰⁵ *Id.* For a discussion of why the government should have the burden to prove a taxpayer willfully failed to file a Foreign Bank Account Report (FBAR), see NAT’L TAXPAYER ADVOC., OBJECTIVES REPORT TO CONGRESS FISCAL YEAR 2017 VOL. 1, THE IRS’S OFFSHORE VOLUNTARY DISCLOSURE (OVD)-RELATED PROGRAMS HAVE IMPROVED, BUT PROBLEMS REMAIN 164–76.

¹⁰⁶ See Blank, *supra* note 67, at 797 (“By actively explaining the specific tax offenses that may result in collateral tax sanctions, the taxing authority may prevent mischaracterizations of the law and the perception that it enlists other agencies to enforce unfair measures.”).

¹⁰⁷ See, e.g., Leo Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 HASTINGS L.J. 239 (1988) (observing that the law generally places the burden of proof on the person with the information to avoid destruction of evidence, places the burden on those challenging the status quo by requesting money from the government or alleging wrongdoing on the part of the government, and avoids requiring someone to prove a negative).

¹⁰⁸ I.R.C. § 7491(c) (providing that the Service has the burden of production with respect to certain penalties).

¹⁰⁹ See, e.g., Johnson, *supra* note 58 (describing practitioner opposition to proposals that would shift the burden of proof to the Service on the basis that such a shift would increase controversy).

some jurisdictions offer other procedural protections before imposing non-monetary tax penalties. Nonmonetary penalties are sometimes applied only if the taxpayer:

- (1) presents an egregious case (*e.g.*, a large or intentional delinquency);¹¹⁰
- (2) is not appealing the liability;
- (3) has been notified that the penalty may apply to him or her; and
- (4) has declined to pay, declined to establish he or she cannot pay, and declined to enter a reasonable payment plan or compromise.

As an example, beginning in 2012, the California Franchise Tax Board (FTB) was required to publish the names of the individuals and businesses (including a corporation's officers) with the 500 largest state tax delinquencies in excess of \$100,000, and for which a notice of tax lien had been filed.¹¹¹ It also coordinated with other agencies to revoke their licenses to conduct business and to drive and to bar them from government contracts.¹¹² These nonmonetary penalties do not apply, however, if the person is disputing the liability, has made payment arrangements, or has filed for bankruptcy, or if the delinquency is uncollectable or has otherwise been resolved. Moreover, the FTB notifies taxpayers by certified mail at least 30 days before posting their names, which gives them notice and a final opportunity to avoid the penalty.

Similarly, in 2015 Congress authorized the Service to work with the U.S. Department of State to deny or revoke the passport of those with "seriously delinquent" tax debts.¹¹³ The penalty only applies to debts of at least \$50,000 (adjusted annually for inflation) that have been assessed, and for which a NFTL has been filed or levy has been issued, and the taxpayer has generally

¹¹⁰ Similarly, the Service generally does not levy on retirement accounts unless the taxpayer's conduct has been "flagrant." I.R.M. 5.11.6.3 (Aug. 16, 2017). It defines flagrant conduct using examples, including: where the failure to pay is based on frivolous arguments; the taxpayer voluntarily (not automatically) contributed to retirement accounts during the time period the taxpayer knew unpaid taxes were accruing; the taxpayer was convicted of tax evasion or assessed a fraud penalty for the tax deb, or assisted others in evading tax; the liabilities arose from illegal income; the taxpayer has a pattern of uncooperative or unresponsive behavior that delayed collection, or has placed other assets beyond the reach of the government. *Id.* The National Taxpayer Advocate recommended legislation to define flagrant conduct "as willful action (or failure to act) which is voluntarily, consciously, and knowingly committed . . . which appears to a reasonable person to be a gross violation of any such provision." NAT'L TAXPAYER ADVOC., 2015 ANNUAL REPORT TO CONGRESS VOL. 1, LEVIES ON RETIREMENT ACCOUNTS 340, 341.

¹¹¹ California Revenue & Taxation Code (RTC) §§ 19195, 7063

¹¹² CA Business & Professions Code § 494.5 (licenses); CA Public Contract Code § 10295.4 (government contracts). FTB, *Top 500 Delinquent Taxpayers*, <https://www.ftb.ca.gov/aboutftb/delinquent-taxpayers.shtml> [<https://perma.cc/9N5N-56YK>].

¹¹³ Fixing America's Surface Transportation (FAST) Act, Pub. L. No. 114-94, § 32101, 129 Stat. 1312, 1729-33 (2015) (codified at I.R.C. § 7345).

been given an opportunity for a collection due process (CDP) hearing.¹¹⁴ The Service will exclude taxpayers who have made arrangements to pay or settle, or if collection is suspended because the taxpayer has requested a CDP hearing or innocent spouse relief (*i.e.*, relief from liability for a debt of his or her spouse).¹¹⁵ It will also exclude those whose accounts are deemed currently not collectable.¹¹⁶

In addition, the National Taxpayer Advocate has recommended that the Service exclude those working with the Taxpayer Advocate Service to resolve the problem.¹¹⁷ She has also recommended that the Service provide taxpayers with a final notice before certifying their delinquencies to the State Department.¹¹⁸ Further, she has argued that the government may be required to provide such a notice before revoking a fundamental right, such as the right to travel. The United States Court of Appeals for the Second Circuit held that laws and regulations that deny or revoke the passports of those owing more than \$5,000 in unpaid child support “comport with due process because they require that . . . [the state provide the accused] with notice and an opportunity to be heard before a passport is denied or revoked.”¹¹⁹ In other words, dispensing with such procedural protections may violate the Due Process Clause.

In summary, when a penalty departs from the norm (*e.g.*, could surprise taxpayers because taxpayers have not been put on notice, is disproportionately severe, imposes strict liability, is vague, is not monetary, or burdens fundamental rights), the penalty is probably at greater risk of being viewed as unconstitutional by the Supreme Court or at least unfair by taxpayers. Procedural protections can, however, rehabilitate penalties that might otherwise be viewed as unconstitutional or unfair, potentially improving the likelihood they will be upheld and preserving their positive impact on voluntary compliance.

V. Conclusion

Deterrence theory suggests we can increase compliance merely by increasing penalty rates, but there is little real-world evidence to support this notion. While increasing the risk of detection seems to improve compliance (at least

¹¹⁴ I.R.C. § 7345(b), (f). In general, the person also must have been given an opportunity to have a collection due process hearing. I.R.C. §§ 7345(b), 6330. According to the legislative history, a person’s passport would be revoked “only after the Service has followed its examination and collection procedures under current law and the taxpayer’s administrative and judicial rights have been exhausted or lapsed.” H.R. Rep. No. 114-357, at 531–32 (2015) (Conf. Rep.), as reprinted in 2015 U.S.C.A.N. 266, 292.

¹¹⁵ I.R.C. § 7345(b).

¹¹⁶ NAT’L TAXPAYER ADVOC., 2017 ANNUAL REPORT TO CONGRESS VOL. 1, PASSPORT DENIAL AND REVOCATION 73–83.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Weinstein v. Albright*, 261 F.3d 127, 135 (2d Cir. 2001).

up to a point), examinations are costly. Other research suggests that people are most likely to follow rules when they are fair, easy to understand and implement, and established by a legitimate and trustworthy authority, provided the authority seems strong enough to detect and penalize noncompliance, and compliance appears to be the norm. In such cases, compliance seems “easy,” “good,” and “smart.” Thus, penalties can promote voluntary compliance, even if they do not provide full economic deterrence for everyone, provided they are not so low or so rarely enforced that compliant taxpayers feel foolish for complying.

While overly severe penalties, strict liability penalties, and nonmonetary penalties could potentially increase deterrence, they are generally inferior options. Nonmonetary penalties may have the most promise because they can leverage other factors and behavioral insights to improve compliance. Although such penalties impose social costs and special risks, in theory, procedural protections could minimize those costs and risks. In practice, however, it may be difficult to administer these penalties in a way that provides sufficient protections, unless the penalties are structured to prevent noncompliance and to avoid unfairly surprising taxpayers.¹²⁰

Finding new ways to penalize and deter conduct that is the norm is likely to erode trust for the government, along with voluntary compliance. To improve the effectiveness of penalties, policymakers should focus on making compliance easier and reducing the opportunities for noncompliance so that penalties rarely need to be applied. If penalties rarely need to be applied, then they are likely to be more effective because only behavior that is outside the norm is penalized. In general, fault-based monetary penalties are most likely to ensure that penalties are applied only to conduct that is outside the norm. With appropriate safeguards, however, preventive, nonmonetary penalties could be effectively used to shift norms in certain industries (*e.g.*, by requiring tax compliance certificates from those entering or maintaining a license in the industry).

¹²⁰ See, *e.g.*, Nat'l Taxpayer Advoc., 2017 Annual Report, *supra* note 116, Passport Denial and Revocation 73–83 (discussing the Service's reluctance to adopt adequate procedural protections).

