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## ESSAY

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### WHAT DOES VOLUNTARY TAX COMPLIANCE MEAN?: A GOVERNMENT PERSPECTIVE

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#### INTRODUCTION

If government statistics are correct, almost all of us engage in what the Internal Revenue Service (IRS) calls “voluntary tax compliance.”<sup>1</sup> One of the IRS’s principle goals is to maximize this voluntary compliance. For example, the IRS has an official policy stating that civil tax penalties are primarily designed and imposed against taxpayers to encourage voluntary compliance.<sup>2</sup> Closing the “tax gap,” the difference between the tax properly due and the amount the IRS receives through voluntary compliance,<sup>3</sup> is a persistent problem for the IRS. In most congressional reports, the IRS emphasizes voluntary taxpayer compliance as a foundational principle of the U.S. tax system.<sup>4</sup>

Yet, most taxpayers do not believe they have a choice when it comes to filing and paying their taxes. There is often a great deal of confusion and consternation when taxpayers discover that the IRS refers to this annual filing ritual as “voluntary.” What does voluntary compliance mean? Does it

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<sup>1</sup> See, e.g., ALAN H. PLUMLEY, IRS, THE IMPACT OF THE IRS ON VOLUNTARY TAX COMPLIANCE: PRELIMINARY EMPIRICAL RESULTS 2 (2002), <http://www.irs.gov/pub/irs-soi/irsvtc.pdf> [<http://perma.cc/2565-WY52>] (as presented at the Annual Conference on Taxation).

<sup>2</sup> See IRM 1.2.20.1.1(1) (Jun. 29, 2004) (“Penalties are used to enhance voluntary compliance.”).

<sup>3</sup> See I.R.S. News Release IR-2012-4 (Jan. 6, 2012) (“The voluntary compliance rate [is] the percentage of total tax revenues paid on a timely basis . . .”).

<sup>4</sup> See, e.g., I.R.S. News Release IR-2014-3 (Jan. 9, 2014) (“The report emphasizes that the U.S. tax system is built on voluntary compliance.”).

mean taxpayers can *volunteer* to file returns and pay taxes, as one might volunteer to make a charitable donation? Does it mean taxpayers do not have to comply with the tax laws if they do not feel like it? How can it be a federal crime to not file or pay taxes if compliance is voluntary?<sup>5</sup> This is a very real problem for taxpayers, as demonstrated by U.S. Tax Court cases litigating taxpayer confusion over the meaning of voluntary compliance.<sup>6</sup> Additionally, at times the Tax Court has taken a very stern position on noncompliance, to the detriment of confused taxpayers.<sup>7</sup>

To the common ear, the term “voluntary compliance” may seem an odd, even Pickwickian, turn of phrase. It implies that compliance with the federal tax laws is voluntary. The Tax Court, however, has labeled such an interpretation as “arrogant sophistry.”<sup>8</sup> Taxpayers have a legal obligation to comply with the tax laws, just as they are obligated to comply with all rules that carry the force and effect of law. Penal sections of the tax code reinforce this obligation.<sup>9</sup> Therefore, the government’s position is that voluntary compliance means that taxpayers behave in a way required by law, but without *direct* compulsion from the IRS.

Still, this definition does not comport with the current use and understanding of the word “voluntary.” The modern connotation implies an act done because one *wants* to do it, not because one *has* to. A voluntary act is an unrestricted act in the absence of a pre-existing obligation. Since taxpayers have a legal obligation to act in accordance with the internal revenue laws, tax compliance is anything but voluntary in this sense.<sup>10</sup>

This Essay offers a government perspective as to why the IRS uses this perplexing term. After investigating (and dismissing) a possible literal

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<sup>5</sup> See I.R.C. § 7203 (1990) (providing criminal sanctions for willful failure to file a return, supply information, or pay tax).

<sup>6</sup> See, e.g., *Waltner v. Comm’r*, 107 T.C.M. (CCH) 1189, 2014 WL 775179, at \*19-20 (2014) (discussing “a fundamental misunderstanding of what it means to have a ‘voluntary compliance’ tax system”); *McKeown v. Comm’r*, 49 T.C.M. (CCH) 781, 1985 WL 14709, at \*1 (1985) (“The concept of voluntary compliance does not refer to whether one volunteers to be liable for tax . . .”).

<sup>7</sup> See *Wilcox v. Comm’r*, 848 F.2d 1007, 1008 (9th Cir. 1988) (imposing sanctions on petitioner because argument that the payment of taxes was voluntary was without merit), *aff’d* 53 T.C.M. (CCH) 741 (1987); see also, I.R.C. § 6673(a)(1) (1989) (authorizing the Tax Court to impose a penalty of up to \$25,000 against taxpayers who make “frivolous” arguments).

<sup>8</sup> *Donelin v. Comm’r*, 47 T.C.M. (IIJ) 1286, 1984 WL 15453, at \*1 (1984).

<sup>9</sup> See, e.g., I.R.C. § 6651(a)(1) (2014) (imposing a civil addition to tax for failure to file); I.R.C. § 7203 (imposing a criminal fine or imprisonment for willful failure to file).

<sup>10</sup> Some authors also question the term “voluntary” given the U.S. tax system’s imposition of information reporting rules and other demands on third parties. Cf. Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 711 (2007) (noting that some reporting rules create “self-enforcing” tax provisions).

defense, the Essay surveys the IRS's history to see why voluntary compliance is such a critical part of the U.S. tax system. The Essay then recommends changing the term from *voluntary* to *cooperative* compliance to retain the government's meaning while lessening taxpayer confusion.

## I. A MEDIEVAL METHOD OF CONSTRUCTION

How can compliance be voluntary if the law compels compliance? Surprisingly, there actually is a way of understanding the term voluntary compliance that is facially consistent with the IRS's definition, but requires—quite literally—a medieval understanding of a voluntary act. In twelfth century Western Europe, a method of learning emerged called scholasticism. One of the most famous scholastics was the philosopher and theologian, Thomas Aquinas. For Aquinas, a voluntary act originates in the will and is guided by knowledge of the end. Certain impediments can reduce the level of “voluntariness” of the act such as ignorance (but not willful blindness), human passion (strong emotion), a rational fear of adverse consequences, and physical force.<sup>11</sup> These impediments do not, however, make an act *involuntary*.

For example, if I am a band leader and Luca Brasi holds a gun to my head while Vito Corleone demands that I sign a release on the contract of my favorite crooner, that act of signing, according to scholastics, is still voluntary.<sup>12</sup> The rational fear of having my brains on the document instead of my signature chips away at some of the “voluntariness” of this act, but Aquinas would still classify the act as generically voluntary even though the act is less voluntary than if I actually wanted to sign the release. So in a tax compliance scenario, even if a taxpayer complies with the tax laws out of a rational fear of the legal consequences for doing otherwise, to a scholastic mind, this would still be an act of voluntary compliance.

## II. A HINT FROM HISTORY

As fun as it might be to find arcane methods that give literal meaning to the IRS's use of the phrase voluntary compliance, resorting to medieval interpretations seems too obscure to be correct. There is no evidence that the IRS ever intended to use the term voluntary compliance in only the scholastic sense. A more likely meaning of voluntary compliance reveals itself through the enforcement history of the IRS.

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<sup>11</sup> THOMAS AQUINAS, *SUMMA THEOLOGICA* pt. I-II, q. 6, art. 1 (Fathers of the English Dom. Province trans., Benziger Bros. 1947) (c. 1225-1274).

<sup>12</sup> Cf. MARIO PUZO, *THE GODFATHER* 42-43 (1969).

The year 1913 witnessed the ratification of the Sixteenth Amendment to the U.S. Constitution. This established the constitutional basis for a federal income tax.<sup>13</sup> Yet, Congress created the agency presently known as the IRS fifty years earlier. The Civil War strained the country's finances, demanding approximately two million dollars a day to service the public debt in 1862.<sup>14</sup> To stem the fiscal bleeding, that same year Congress created a federal tax authority known as the Office of the Commissioner of Internal Revenue.<sup>15</sup> Acting Commissioner Joseph J. Lewis makes clear in the agency's first annual report that any direct assessment responsibility would be too heavy a burden for his fledgling agency, and the total tax due to the government would not be collected under such a system simply because his office could not make all the necessary assessments.<sup>16</sup> Although the tax authority's payroll quickly grew, its resources never came close to being able to directly assess taxes against each individual taxpayer.

Nor could it keep up with the demands of auditing tax returns. The early revenue laws after 1913 required the Commissioner to examine (audit) each and every return filed.<sup>17</sup> This became another Sisyphean task. By 1954, the IRS<sup>18</sup> was only able to audit about 2.1% of all returns filed.<sup>19</sup> The Internal Revenue Code of 1954 removed the requirement that the Commissioner examine every return.<sup>20</sup> Currently, the IRS audits less than 1% of all filed tax returns.<sup>21</sup>

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<sup>13</sup> U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived . . .").

<sup>14</sup> Congress had authorized an income tax in 1861, but it was never collected. Act of August 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862). In 1862, a new revenue act established a two-phase progressive system of taxation based on income, consisting of a 3% rate on income over \$600 and a 5% rate on income over \$10,000. Act of July 1, 1862, ch. 119, § 90-93, 12 Stat. 432 (1862). The Act also required that taxes be withheld by employers. *Id.* § 91.

<sup>15</sup> *Id.* § 1.

<sup>16</sup> COMM'R OF INTERNAL REVENUE, REPORT ON THE OPERATIONS OF THE INTERNAL REVENUE SYSTEM FOR THE YEAR ENDING JUNE 30, 1863 11 (1863) ("[The income tax], though as fair in theory as any that can be laid, has been found by the experience of other countries to be incumbered with practical difficulties in the assessment which have deprived it of all claims to public favor.").

<sup>17</sup> See Revenue Act of 1918, Pub. L. No. 65-254, § 250(b), 40 Stat. 1057, 1083 (1919) ("As soon as practicable after the return is filed, the Commissioner shall examine it.").

<sup>18</sup> The President significantly restructured the agency in 1952. See Reorganization Plan No. 1 of 1952, 17 Fed. Reg. 2243 (Mar. 15, 1952). In 1953, the name was officially changed to the "Internal Revenue Service." Change of Nomenclature, 18 Fed. Reg. 1520 (Aug. 27, 1953).

<sup>19</sup> See COMM'R OF INTERNAL REVENUE, ANNUAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 1954 6, 12 (1955) (showing the agency examined 4,902,000 out of the 88,887,000 total returns filed in 1954).

<sup>20</sup> See Internal Revenue Code of 1954, Pub. L. No. 83-591, vol. 68A, § 7601-7602 (current version at I.R.C. § 7601-7602) (authorizing the Secretary to "the extent he deems it practicable"

From this brief history—and considering the governmental perspective—one can better understand what the IRS means when it says the U.S. tax system is based on voluntary taxpayer compliance. It means that the tax authority does not have adequate resources, and never did, to assess taxes against each taxpayer directly or audit every return. Since the IRS cannot execute either of these practices, it instead relies on individual taxpayers to accurately assess their own tax liability on annual returns and timely pay the correct amount due.<sup>22</sup>

This is the reason the IRS says it relies on a system of voluntary compliance. The agency's own history and experience show that it simply cannot operate any other way. Over 97% of all the revenue the IRS brings in every year is from this voluntary (neither directly assessed nor audited by the agency) compliance. Only about 3% comes from “enforced compliance,” meaning the IRS audits returns and collects additional tax.<sup>23</sup>

It would, perhaps, be more accurate to say that the U.S. tax system is based on a “self-assessment-with-a-low-audit-rate” practice, but that somehow does not sound as attractive as voluntary compliance. Voluntary compliance sounds like Americans *want* to pay taxes, and that they do so gladly. There is a chest-swelling sense of patriotism implied in the phrase that actually might encourage voluntary compliance in the taxpaying population. It also markets the “America rocks” image globally, as the U.S. has one of the highest voluntary compliance rates in the world.<sup>24</sup> Therefore, the term voluntary compliance seems to serve multiple purposes: some idiomatic, others perhaps political.

### III. TOWARD A COOPERATIVE TAX COMPLIANCE SYSTEM

Yet, I believe there is a better option. As long as the word “voluntary” retains its modern, non-medieval meaning, and as long as taxpayers' brows

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canvas each district for potential taxpayers and authorizing but not requiring the Secretary to perform various examinations of returns).

<sup>21</sup> See INTERNAL REVENUE SERV., DATA BOOK, 2013, 21-24 (2014) (showing the audit rate for all tax returns reported as 0.8%).

<sup>22</sup> Cf. *Donelin v. Comm'r*, 47 T.C.M. (IIJ) 1286, 1984 WL 15453 (1984) (“[I]n spite of its extensive bureaucracy and technical equipment, the manpower and facilities of the IRS for policing compliance by every taxpayer are limited and [therefore] the effectiveness of the system depends upon the taxpayer's voluntary obedience to the law.”).

<sup>23</sup> See J. T. Manhire, *There Is No Spoon: Reconsidering the Tax Compliance Puzzle*, 17 FLA. TAX REV. 623, 624-25, 625 n.3 (2015) (calculating revenue from enforced collection to be 2.86% of all revenue that the IRS collects).

<sup>24</sup> See Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 973-74, 974 n.17 (2003) (noting that the United States enjoys one of the highest tax compliance rates).

furrow in puzzlement every time they hear the term voluntary compliance, confusion will endure. For the sake of clarity, I recommend that the IRS change the term from *voluntary* compliance to *cooperative* compliance.

It helps to think about the taxpayer/tax authority interaction in the four-field graph so familiar to game-theoretic explanations.<sup>25</sup> Essentially, taxpayers have two conscious choices when faced with the decision whether to comply with the tax laws: *cooperate* or *evade*. Similarly, the IRS has two choices when faced with a tax return: *audit* or *not audit*.<sup>26</sup> What the IRS calls voluntary compliance resides in the bottom left corner of Table 1, where the taxpayer chooses to cooperate and the IRS chooses to not audit. This is typically where both the taxpayer and the IRS want to be. The taxpayer fully cooperates by complying and the IRS leaves the taxpayer alone. This can properly be called the *cooperative compliance* quadrant of the graph.

Table 1: Behavioral Choices of Taxpayers and the IRS

		Taxpayer	
		Cooperate	Evade
IRS	Audit	Harassment	Busted
	Not Audit	Cooperative Compliance	Chump

If the IRS audits cooperative taxpayers too often, taxpayers might begin to feel harassed. Taxpayers certainly do not want to be in the *harassment* quadrant, nor does the IRS. A sense of harassment on the part of cooperating taxpayers could lead to less cooperation in the future.

If the taxpayer evades and the IRS does not audit, the IRS is in the position of the chump. The government does not want to be in the *chump* quadrant. If the taxpayer evades and the IRS audits, then the evading taxpayer is (most likely) caught and the IRS metes out the appropriate statutory consequences. The taxpayer definitely does not want to be in this *busted* quadrant, nor does the IRS since enforcement can be expensive for the agency. In the end, the taxpayer population is better off maximizing cooperation and the IRS is better off minimizing audits.

<sup>25</sup> Here, I follow John Scholz's game-theoretic model based on the classic prisoner's dilemma. See John T. Scholz, *Voluntary Compliance and Regulatory Enforcement*, 6 LAW & POL'Y 385, 389-91 (1984) (showing how encouraging a cooperative strategy reduces unnecessary costs associated with direct enforcement).

<sup>26</sup> See J. Manhire, *Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance Models*, 33 VA. TAX REV. 629, 635-36 (2014) (outlining these choices for the taxpayer population and government).

When one regards the concept of voluntary compliance within this framework, along with the IRS's history, it makes more sense why the IRS seeks to maximize voluntary compliance. Yet, a more accurate and useful term would be cooperative compliance. Similar to voluntary compliance, it is less confusing, and the phrase does not have to abandon its appeal as it would if the IRS adopted the self-assessment-with-a-low-audit-rate system moniker.

#### CONCLUSION

Voluntary tax compliance does not mean *volunteering* to comply with the tax laws. Although one can look to medieval ideas of the voluntary act to reconcile the IRS's use of voluntary compliance, it seems bizarre to square the confusion in this way. It is also unnecessary. A quick review of the IRS's assessment and examination history shows that the IRS simply cannot keep up with a system that requires it to either directly assess individual income tax or examine every filed tax return. Voluntary compliance, then, is the IRS's reliance (read *dependence*) on taxpayers to assess the correct amount of tax on their returns, file those returns properly, and timely pay the tax due.

Yet, even with this explanation, the term can be improved for clarity. Understanding the relationship between the IRS and the taxpayer in a game-theoretic model shows that the IRS relies on taxpayers to cooperate with the tax laws and taxpayers rely on the IRS to (usually) leave them alone if they do so. For this reason, it would be clearer for the IRS to state that the U.S. tax system is based on cooperative compliance.

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