THE INTRINSIC FLAW IN TAXATION IMPEDING TAX COMPLIANCE

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Would you like to decide how your tax payments are used? Let us elaborate the question: would you like to decide how your tax payments are used without interfering with equity issues? Do you think it will induce you (and your neighbors) to pay taxes?

This paper examines whether we should advocate a normative principle for allocating tax payments—beyond revenue raising—to enhance tax compliance. The paper endeavors to tackle tax evasion from a specific angle by understanding the intrinsic flaw in taxation—the unrequited payment factor. The paper presents the newly coined *de jure benefit principle*, somewhat in line with the Wicksellian approach, which helps both to preserve equity and enhance tax compliance. The new principle does not mean that people pay for the public goods they *consume* but rather that they choose how their tax dollars are *spent*, without directly interfering with state sovereignty. The paper proposes a mechanism for implementing the *de jure benefit principle* by linking the expenditure side to revenue raising to enhance tax compliance without affecting equity considerations or radically transforming the current system.

INTRODUCTION

This paper examines whether we should advocate a normative principle for allocating tax payments—beyond revenue raising—to enhance tax compliance. The paper endeavors to tackle tax evasion from a specific angle by understanding the intrinsic flaw in taxation—the unrequited payment factor. This tax evasion problem arises partly due to a conflict of interests but mainly due to lack of information flow from both the state to the taxpayer and in the opposite direction. This dual information flow problem means that the government cannot always fully assess taxpayers' income (Type I agency problem) and that the taxpayer cannot assess how the government spends his taxes (Type II agency problem). This paper discusses the problematic linkage between those two agency problems — tax evasion and lack of information on government spending. The perceived remoteness of the compulsory payment from its benefit, combined with particular taxpayer cognitive biases also discussed below, is critical to the compliance discussion.

The paper presents the newly coined *de jure* benefit principle, which helps both to preserve equity and enhance tax compliance. The new principle does not mean that people pay for the public goods they *consume* but rather that they choose how their tax dollars are *spent*, without directly interfering with state sovereignty. The paper proposes a mechanism for implementing the *de jure* benefit principle by linking the expenditure side to revenue raising to enhance tax compliance without affecting equity considerations or radically transforming the current system. Thus, the proposal detailed below can overcome some intrinsic flaws in taxation.

In order to maintain government sovereignty and at the same time also equity, the proposed mechanism is only applicable to tax systems which partly use voluntary tax compliance. The *de jure* benefit principle is somewhat in line with the Wicksellian approach. It strengthens the information flow between the taxpayers and the government, thereby solving Type I and Type II agency problems. Consequently, it can dramatically mitigate underreporting and underpayment problems generated by the intrinsic flaw of taxation, and increase tax compliance.

The paper is interdisciplinary, relying on both behavioral economic insights and theoretical tax discourse. It should be noted that the application of the psychological perspective is not unique in legal debates.

Analysis based on behavioral economics literature can be found both in law in general and in tax law in particular. Feldman and Lobel, for example, examine legal mechanisms promoting whistleblowing in various legal fields such as labor and tax law through the lenses of behavioral economics.[1] McCaffery and Baron, on the other hand, focus chiefly on tax law in their discussion of the much broader question of tax policy and redistribution, and employ a behavioral model.[2]

The tax compliance literature based on behavioral economics is extensive and has yielded many intriguing recommendations. For example, Mazar, Amir and Ariely use a laboratory experiment to examine how to influence individual self-awareness with regard to taxation.[3] One of their proposals is to have taxpayers sign an honor code prior to filing the tax return to encourage honesty. Although not directly related to the questions at stake here, their work has inspired us. We are also indebted to Listokin and Schizer's work[4] which will be referred to in greater detail below.

In general, the behavioral economics literature is particularly important in the context of tax compliance where collecting tax is mainly the result of willingness to declare incomes and pay taxes. Some golf fans (or actually vice versa — golf anti-fans) might be interested to know that Ariely analogizes golf to taxes: "golf and taxes seem to turn up a lot."[5] In a questionnaire study of golf players' honesty it was found that some golfers do not mind moving the ball a bit further to get a better score.[6] Ariely

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1. Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties, and Protections for Reporting Illegality*, 88 TEX. L. REV. 1151 (2010) (examining individuals' motivation to report illegal activity (especially illegal employment)).

2. Edward McCaffery & Jonathan Baron, *The Political Psychology of Redistribution*, 52 UCLA L. REV. 1745 (2005).

3. Nina Mazar, On Amir & Dan Ariely, *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MARKETING RES. 633 (2008).

4. For a discussion of the similarities and dissimilarities between this paper and Listokin & Schizer, see discussion accompanying footnote 138. *See* Yair Listokin & David M. Schizer, *I Like To Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179 (2013) (suggesting some tax policy applications based on the unproven proposition that taxpayers would tend to comply with tax payments if they could have supported the method in which their money is spent).

5. Dan Ariely, *The Encyclopedia Of Ethical Failure. . .*, DAN ARIELY (Dec. 1, 2012), http://danariely.com/2012/12/01/the-encyclopedia-of-ethical-failure/ [https://perma.cc/K753-KCZV].

6. Dan Ariely, THE (HONEST) TRUTH ABOUT DISHONESTY: HOW WE LIE TO EVERYONE – ESPECIALLY OURSELVES 55-66 (2012); Scott McKenzie, Driven to Cheat: A Study on the

claims that people tend to cheat more when there is psychological distance between the act and the outcome[7] — just like when playing golf or filing a tax return. As Will Rogers famously put it, "the [i]ncome [t]ax has made more [l]iars out of the American people than [g]olf has."[8]

Section II presents the problem of tax evasion. Section III presents the principal models of both utility maximizing and behavioral economic theories. Readers familiar with these subjects may wish to skip this introductory section. Next, Section IV addresses the rationales of tax evasion and explores related specific cognitive biases. The following section presents empirical findings on the correlation between tax and return. This brings us to Section VI which defines tax and mainly its third component—quid pro quo. Section VII proposes the *de jure* benefit principle and the innovative recommendation derived from it, followed by a concluding section.

I. THE TAX EVASION PROBLEM

The problem of tax evasion is ubiquitous and has been recognized since ancient times.[9] It is straightforward: if citizens do not pay their share to civil society, the government will be unable to offer appropriate services to the public. Moreover, all citizens freely consume the services offered by the government including those free riders who have evaded tax. Evasion also means that if a person with similar welfare to another evades while the other complies, it infringes the equity principle. Finally, tax evasion hinders redistribution.

Since it is clear that when the government faces revenue deficiency (*i.e.*, tax gap)[10] it cannot provide adequate services, it is worthwhile to quantify the tax gap.[11] The estimated tax gap for 2006 in United States was

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Drivers of Dishonesty–through the Game of Golf 40-41 (Apr. 2009) (unpublished A.B. thesis, Duke University), http://dukespace.lib.duke.edu/dspace/bitstream/handle/10161/1400/McKenzie%2c%20Scott.pdf [https://perma.cc/9PNY-Z8RT].

7. Ariely, *supra* note 6, at 59.

8. Will Rogers, *Helping the Girls with Their Income Taxes*, in THE ILLITERATE DIGEST 72 (1924) (as quoted in ESSENTIAL QUOTATIONS DICTIONARY 436 (1998)).

9. *See generally* Samuel Blankson, *A Brief History of Taxation* (2007) (discussing the taxes in the context of Ancient Egypt, China, Greece, India, and the Inca and Roman Empires).

10. Tax gap is the difference between tax that *should* have been paid by taxpayers and their de facto payments and consists of three elements: non-filing, underreporting and underpayment. Ed Nannenhorn, *Tax Administration, Federal*, ENCYCLOPEDIA OF TAXATION & TAX POLICY 383 (Joseph J. Cordes et al. eds., 2005). Thus, tax evasion constitutes part of the tax gap.

11. *See* Jacqui McManus & Neil Warren, *The Case for Measuring Tax Gap*, 4(1) EJ.

$385 billion.[12] It was further estimated that 83% of taxpayers paid their taxes voluntarily on time and that 85.5% eventually paid their tax liability.[13] This means a 14.5% noncompliance rate.[14]

Though people tend to think that it is mainly businesspersons who evade tax, studies indicate differently. Even the "average" person tends to cheat if only he has the opportunity to do so. In the 1980s an exemption allowance was granted to dependents in the US.[15] Taxpayers claimed this exemption via their tax returns. For claiming this exemption, taxpayers were not requested to disclose full details on their dependents such as their social security number. Tax authorities suspected that taxpayers did not accurately declare their dependents, so the regulation was slightly amended, requiring taxpayers to also submit the dependent's SSN. Lo and behold, within one year seven million dependents faded away from American society and the public treasury grossed an extra three billion a year.[16]

As tax evasion is a major concern for governments around the world, many mechanisms have been developed to mitigate the problem. Accordingly, the tax evasion literature is preoccupied with understanding how taxpayers would react to each proposed law. It can be roughly divided into the utility maximizing theory and behavioral models; these are briefly

TAX RES. 61 (2006) (discussing the pros and cons of "tax gap" estimation).

12. I.R.S. News Release IR-2012-4 (Jan. 6, 2012) — *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study [https://perma.cc/27MT-7F9D].

13. *Id*.

14. There are three main kinds of tax evasion: non-filing, underreporting and underpayment. *Id*. In some countries such as Canada the tax authorities do not fully calculate the tax gap. *See* Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 33 (2007) ("No other country has undertaken a broad-based analysis of tax evasion like the Taxpayer Compliance Measurement Program or the National Research Program.") [hereinafter Slemrod, *Cheating Ourselves*]. Also, in Australia, the tax authorities do not attempt to calculate the overall tax gap but rather specific tax gaps which may be significant. McManus & Warren, *supra* note 11, at 70. For instance, the goods and services tax (GST) gap for 2012-2013 was estimated at $3.1 billion (excluding debt), or 6% of the theoretical revenue. *GST Administration Annual Performance Report 2013-2014*, AUSTL. TAX'N OFF., https://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/GST-administration-annual-performance-report-2013-14/?page=13 [https://perma.cc/Q46F-CQ9N] (last modified Dec. 22, 2014).

15. *See* John A. Szilagyi, *Where Have All the Dependents Gone?*, INTERNAL REVENUE SERVICE TREND ANALYSIS AND RELATED STATISTICS – 1990 UPDATE (Publication 1500 (August), Washington DC: IRS, 1990) as referred to in Joel Slemrod & Jon Bakija, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 175-76 n. 43 (4th ed. 2008) (discussing the impact of requiring dependents over the age of 5 to report their Social Security number to claim the exemption).

16. *Id*.

explored in the following section.

II. RATIONAL CHOICE AND BEHAVIORAL ECONOMIC MODELS OF COMPLIANCE

The basic rational choice model treats taxpayers as rational actors who wish to maximize their profits. This means that the rational taxpayer is able to process the relevant information and evade tax when the expected utility exceeds the expected loss (in the form of fines and other sanctions).[17] Dishonesty, then, is perceived as a rational action performed by an individual who is simply self-centered.

One of the main faults of the utility maximizing theory is that it does not reflect reality. Given a very low audit probability and relatively low expected legal penalties in addition to relatively high rates of voluntary tax compliance, the utility maximizing theory is insufficient.[18] Some scholars thus suggest that individuals comply with the law due to a "general norm of law-abiding behavior."[19]

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17. See Becker's pioneering work: Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 176 (1968) (taking the approach that "follows the economists' usual analysis of choice and assumes that a person commits an offense if the expected utility. . . exceeds the utility he could get by using his time. . . at other activities."). A landmark research following Becker's work on tax compliance was performed by Allingham and Sandmo: Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323 (1972). This latter work served as the basis for an extensive literature, such as Yitzhaki's work which modifies the Allingham-Sandmo model: Shlomo Yitzhaki, *A Note on Income Tax Evasion: A Theoretical Analysis*, 3 J. PUB. ECON. 201 (1974).

18. *See* James Andreoni, Brian Erard & Jonathan Feinstein, *Tax Compliance*, 36 J. ECON. LITERATURE 818, 821 (1998) ("The fact that most taxpayers face a low probability of detection and small expected penalty puts the earlier statistics on noncompliance in a different light."); *see also* Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1784 (2000) ("Given the low penalty for tax evasion and the audit rate, tax evasion should be widespread. Yet the IRS estimates that 83% of taxes are collected.").

19. Posner, *supra* note 18, at 1782. Posner believes that the explanation for this phenomenon is the signaling model, where people obtain some private information about their preferences (*id*. at 1787); nevertheless, "if information were costless, so that individuals knew all the characteristics of potential cooperative partners, social norms would not exist." *Id*. at 1819. *But see* Dan M. Kahan, *Commentaries on Eric Posner's Law and Social Norms: Signaling or Reciprocating? A Response to Eric Posner's Law and Social Norms*, 36 U. RICH. L. REV. 367 (2002) (Kahan opposes Posner's reputational signaling model and supports the reciprocity model. The author believes that the latter model is better understood under three criteria—behavioral realism, political feasibility and moral acceptability). For the discussion on tax morale *see generally* Benno Torgler, *Moral Suasion: An Alternative Tax Policy Strategy? Evidence from a Controlled Field Experiment in Switzerland*, 5 ECON. GOV. 235, 236 (2004) (analyzing the effects of "moral suasion on tax morale").

In 1967 a field study by Schwartz and Orleans already showed that in general, taxpayers react to moral appeals more than to simply legal sanctions, though both have effects on individuals.[20] This study indicates the shortcomings of the utility maximizing theory. Behavioral economic models, therefore, point out that there is more to cost-benefit analysis and that rational models cannot fully explain taxpayers' compliance.[21] Individuals tend to act emotionally and sometimes base their decisions on heuristics since the process of getting and absorbing information is costly. Much of the neoclassical economic models are based on the idea that economic actors respond to external incentives. Social psychology introduces "tax morale,"[22] the term intrinsic motivation[23] (such as honesty and altruism),[24] and other explanations challenging neoclassical thought.[25] Accordingly, individuals voluntarily comply with tax payment thanks to social and personal norms such as trust, altruism and reciprocity.[26]

20. *See* Richard D. Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 U. CHI. L. REV. 274 (1967) (arguing that it is not a rational decision to react to legal sanctions because of deterrence, but rather because it induces moralism).

21. *See, e.g.*, Andreoni et al., *supra* note 18, at 850 (discussing the incorporation of morals and social dynamics into the models); Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599, 604 (2007) [hereinafter Kornhauser, *Tax Morale Approach*] (discussing the incorporation of "moral, psychological, and social factors influencing tax compliance."); Benno Torgler et al., *Is Forgiveness Divine? A Cross-Culture Comparison of Tax Amnesties*, 139 SCHWEIZ. ZEITSCHRIFT FÜR VOLKSWIRTSCHAFT UND STATISTIK 375, 392 (2003) (discussing how differences in social norms and social institutions influence tax compliance rates cross culturally).

22. *E.g.*, Torgler, *supra* note 19, at 236; Kornhauser, *Tax Morale Approach*, *supra* note 21, at 602.

23. *See* Bruno S. Frey & Reto Jegen, *Motivation Crowding Theory*, 15 J. ECON. SURV. 589, 589-91 (2001) (showing the development of the intrinsic motivation).

24. *See, e.g.*, Kornhauser, *Tax Morale Approach*, *supra* note 21, at 612-17 (discussing the role of honesty and altruism).

25. Frey & Jegen, *supra* note 23, at 590, 591. *See* Erich Kirchler, THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOUR 117-118 (2007) (discussing taxpayers' subjective behaviors); Bruno S. Frey, *A Constitution for Knaves Crowds Out Civic Virtues*, 107 ECON. J. 1043 (1997) (discussing the civil virtue explanation).

26. *See* Kornhauser, *Tax Morale Approach*, *supra* note 21, at 602-03 ("[S]ocial norms, personal values and various cognitive processes . . . strongly affect an individual's voluntary compliance with laws."); Listokin and Schizer, *supra* note 4, at 185-87 (discussing the role of trust and altruism in fostering tax compliance). For the correlation between intrinsic and extrinsic motivation in general, *see* Frey & Jegen, *supra* note 23; Uri Gneezy & Aldo Rustichini, *A Fine is a Price*, 29 J. LEGAL STUD. 1 (2000). For the correlation between intrinsic and extrinsic motivation in the tax field, see Catherine C. Eckel, Philip J. Grossman and Rachel M. Johnston, *An Experimental Test of the Crowding out Hypothesis*, 89 J. PUB. ECON. 1543 (2005) (finding that when a payment was introduced as compulsory, it caused a crowding-out effect); see also Frey & Jegen, *supra* note 23, at 605) (finding that a distrustful tax law impairs tax morale and increases evasion). Additional financial punishment may erode intrinsic motivation, Erich Kirchler, Erich Hölzl

III. WHY DO PEOPLE PAY (OR EVADE) TAX?

A. *Noncompliance Explanations*

As noted above, some people voluntarily comply with tax payment because of "tax morale," but still why do some people pay taxes[27] while others evade them? Below we shall present some reasoning for tax evasion. Nevertheless, since the literature on tax evasion is extensive, this is just a brief outline of the key approaches.

Cost-Benefit Analysis: As presented above, rational individuals make a cost-benefit analysis, balancing the costs of being detected with the benefits of successful evasion. They may estimate the enforcement and auditing probabilities[28] and realize that the chance of being caught may be very low. This reasoning is attributed to the rational choice theory.[29] Nevertheless, a recent study shows that the sanctions for evasion are not necessarily merely monetary, but also nonmonetary (referred to in the literature as "collateral tax sanction").[30]

The Libertarian Approach and Alienation: Some people may be self-interested and believe that the money they have made is theirs and the government is not entitled to tax them.[31] This libertarian approach may also suggest that those people do not feel part of a community or society.[32] On the contrary, it seems that people tend to pay more taxes if they feel that

& Ingrid Wahl, *Enforced Versus Voluntary Tax Compliance: The 'Slippery Slope' Framework*, 29 J. ECON. PSYCHOL. 210 (2008), but not when it helps increase the sense of fairness among taxpayers. Frey, *supra* note 25, at 1049. A specific illustration of the effect of tax rewards on tax morale is the research on tax amnesties. *See* Torgler et al., *supra* note 21 (examining whether tax amnesties interfere with individuals' moral standards and finding that "civic duty" increases compliance). For a new approach combining intrinsic and extrinsic motivation into one model, see Mazar, *On Amir & Ariely*, *supra* note 3.

27. For a discussion on "why do people pay taxes," see Joshua D. Blank, *Collateral Compliance*, 162 U. PA. L. REV. 719, 746-48 (2014).

28. *See, e.g.*, James Alm et al., *Fiscal Exchange, Collective Decision Institutions, and Tax Compliance*, 22 J. ECON. BEHAV. & ORG. 285, 291-93 (1993) (weighing the tax rate, the audit rate, and the penalty rate in the voluntary compliance system). There are over 100 different civil tax penalties in the Internal Revenue Code (IRC). Blank, *supra* note 27, at 729 (citing U.S.C. §§ 6651-6702 (2012)).

29. The rational choice theory is briefly described in Section II.

30. Those nonmonetary sanctions are not applied by the IRS, but rather by non-tax agencies and can be briefly defined as "additional penalties that occur outside of the tax system." Blank, *supra* note 27, at 735. However, the collateral tax sanction theory is based on behavioral research, not on the rational choice theory. *Id.* at 725.

31. This view is contrary to the view that it is the citizens' moral duty to pay taxes. *See, e.g.*, Blank, *supra* note 27, at 766 (discussing how collateral tax sanctions reinforce individuals' feeling that tax compliance as a duty of citizenship).

32. For a contrary argument showing that people may pay when they sympathize with the cause, see Listokin & Schizer, *supra* note 4, at 190-91 and accompanying references.

they belong to a smaller group.[33]

Coercion: Another explanation is simply that people do not like to be coerced to pay money. Some studies show that people volunteer to donate even if they complain that their taxes are too high.[34]

Unfairness: Some people believe that taxes are simply unfair. For example, studies show that Americans believe that rich people do not pay enough taxes.[35] On the contrary, where taxes are regarded as fair, individuals tend to comply with tax payments.[36]

Reciprocity and Social Acceptance: In some societies, it is socially accepted or at least non-reproachable to evade. Tax evasion in those societies is not considered to be an intolerable act.[37] Another explanation, related to the "fairness" argument above, is that if people believe that their neighbor does not pay taxes they wonder why they should pay.[38]

Outcome Remoteness: Other individuals are disinclined to pay taxes because they believe governments disregard their wishes.[39] A similar but slightly different phrasing is that there are individuals who feel their tax payments are misused. This is the Type II agency problem described above.

This brief discussion shows that the reasoning for tax evasion is highly varied. A single model cannot encompass all the hypothesized causes of tax evasion. This paper focuses on the latter problem—the argument that taxpayers do not agree with the way the government is spending their tax dollars (Type II agency problem).

B. *Human Biases: Identifiable Victim Effect, Isolation Effect & Other "Short-Term Biases"*

The studies described above demonstrate that we cannot discuss tax compliance and offer legal revisions without first understanding human

33. *See, e.g.*, *id.* at 186-87 (discussing the "size and in-group effects").

34. *See* Sherry Xin Li et al., *Giving to Government: Voluntary Taxation in the Lab*, 95 J. PUB. ECON. 1190 (2011) (exploring the inconsistency between negative attitudes about taxation and donations to non-profit causes).

35. *See* Slemrod & Bakija, *supra* note 15, at 72 (describing an April 2006 Gallup poll where 67% of people felt that "upper-income people" paid "too little" in tax payments).

36. This is part of the tax morale writings discussed in Section III; *see also* Listokin & Schizer, *supra* note 4, at 185-86 (noting that a perception of fairness in tax administration raises tax compliance rates).

37. Kirchler, *supra* note 25, at 65.

38. *See* Ernst Fehr & Simon Gächter, *Reciprocity and Economics: The Economic Implications of Homo Reciprocans*, 42 EUR. ECON. REV. 845, 854 (1998) (discussing how people are motivated by reciprocity outside of the taxation context).

39. *See* Alm et al., *supra* note 28, at 285 (noting that individuals may be less inclined to pay taxes when they feel that government is unresponsive to their wishes).

nature and people's reasoning for evading tax. Behavioral models recognize that there is more to cost analysis, and individuals may comply and pay their taxes due to an inner moral call, a motive that can often be manipulated.[40]

The behavioral economics literature is replete with discussions of cognitive biases. Here we would like to present only the deficiencies pertinent to the question presented in the paper, starting with the identifiable victim effect.

Let us put tax issues aside for now and concentrate on other issues. How would you react if you were informed of a tragedy suffered by a specific individual, as opposed to a natural catastrophe where thousands of people unknown to you lost their relatives and homes? Utilitarian social welfare may treat the latter as a much severer loss for society, but studies show that you probably feel more empathy towards the former individual who experienced a personal tragedy. This is due to the identifiable victim effect.[41] Scholars dispute the factors behind this effect, and several have been offered in the literature.[42] First, the vividness factor—the vivid image of the identified victim makes us feel we know the person and thus care more about him.[43] Second, the certainty and uncertainty factor related to prospect theory and the finding that people are risk averse to losses. The identified victim could be conceptualized as a certain gain and thus preferable to unidentified potential victims.[44] Third, the reference group effect[45]— people tend to care more about risk that occurs in a smaller area.

40. *See, e.g.*, Kornhauser, *Tax Morale Approach*, *supra* note 21 (recommending various mechanisms to apply behavioral economic thinking—especially tax morale—to enhance compliance based on a behavioral economic survey). Kornhauser's three recommendations are based on the idea of tax morale as discussed in behavioral economics: first, establish a separate IRS division to survey tax morale; second, adopt a tax morale approach to compliance by recognizing taxpayers' intrinsic motivation; and third, educate society to comply with tax payment. *Id.* at 626. Kornhauser believes that education is an important mechanism that can contribute to disciplining taxpayers to file returns on time, feel less frustrated by tax complexity and feel a greater sense of reciprocity and fairness. *Id.* at 629, 631. She also recommends starting the tax education process from an early stage to help shape tax morale. *Id.*

41. Karen E. Jenni & George Loewenstein, *Explaining the "Identifiable Victim Effect"*, 14 J. RISK & UNCERTAINTY 235, 236 (1997); Deborah A. Small & George Loewenstein, *Helping a Victim or Helping the Victim: Altruism and Identifiability*, 26 J. RISK & UNCERTAINTY 5 (2003) [hereinafter Small, *Helping a Victim*]; Deborah A. Small & George Loewenstein, *The Devil You Know: The Effects of Identifiability on Punishment*, 18 J. BEHAV. DECISION MAKING 311, 311-13 (2005).

42. *See* Jenni & Lowenstein, *supra* note 41, at 237-39 (discussing potential causes of the identifiable victim effect).

43. *Id.* at 237.

44. *Id.* at 238.

45. This effect received vast empirical support. *See, e.g.*, Small, *Helping a Victim*,

For example, people are more deeply affected by a story that "X out of X" people will die than the same amount of casualties out of millions. Identified victims are analogous to the first case since they create their own reference group.[46] Finally, ex-post versus ex-ante evaluation: usually, the decision to take action with regard to an identified victim is ex-post and with regard to statistical victims it is ex ante. Once the tragedy has occurred it is more difficult for people to escape feelings of blame and responsibility.[47]

Out of the four major explanations proposed, experiments support mainly the reference group explanation for the identifiable victim effect.[48] Some scholars termed this phenomenon "psychophysical numbing,"[49] since people actually consider the same amount of lives saved to be much higher when the tested group is smaller. In other words, they look at the proportion of lives that can be saved and prefer a higher one; otherwise they feel they save only "a drop in the bucket."[50] Other studies showed that people react emotionally even to a weak version of identifiability without concrete information on the victim's identity.[51] Thus, it is sufficient to point out a victim out of lists of victims to trigger the effect.[52]

The implication of the identifiable victim effect for taxation may indicate that people cannot grasp the consequences of tax evasion since the victim is too indeterminate. But in order to better understand how the distance between individual actions and government performance may influence taxpayers, we have to look for other cognitive biases, such as the isolation effect. In other words, the degree of remoteness between the compulsory payment and the benefit incurred from it is related to the isolation effect. Also called the "focusing effect,'[53] it means that "[p]eople tend to isolate or focus on a narrow choice problem before them, ignoring relevant information"[54] that is not presented to them "and otherwise failing to integrate their logically connected judgments and decisions into a coherent whole."[55] Thus, it may lead individuals to incoherent

supra note 41, at 6 (noting that people feel greater concern toward victims as their reference group decreases in size).

46. *See* Jenni & Lowenstein, *supra* note 41, at 238-39 (noting that identifiable victims represent greatly concentrated distributions of risk within a reference group).

47. *Id*. at 239.

48. *Id*. at 253-54; David Fetherstonhaugh et al., *Insensitivity to the Value of Human Life: A Study of Psychophysical Numbing*, 14 J. RISK & UNCERTAINTY 283 (1997).

49. Fetherstonhaugh et al., *supra* note 48, at 284.

50. *Id*. at 285.

51. Small, *Helping a Victim*, *supra* note 41, at 7, 14.

52. *Id*. at 11, 13-14.

53. McCaffery & Baron, *supra* note 2, at 1751.

54. *Id*.

55. *Id*.

preferences.[56] The isolation effect is not the only factor causing individuals to ignore relevant input before making a decision, though. Decisions are also due to simplification[57] or other cognitive biases that cause myopia. To some extent, individuals are bound to consider sophisticated components and take information relevant in the future into consideration. For our purposes, those decision making short cuts can be grouped together as "short-term biases."

The direct implication of short-term biases for the present discussion is that taxpayers are incapable of properly assessing government spending. Government spending involves politics and is not transparent (Wicksell refers to this problem in the nineteenth century).[58] Even if government spending were transparent, it is questionable whether prior to paying taxes or filing a statement, any citizen could process all relevant information on complex budgetary issues. McCaffery and Baron believe that due to short-term biases, people see just what directly affects them without being able to take public finance issues (such as redistribution) into account.[59] As a result, they do not think two steps ahead to understand that when they evade, someone is going to suffer.[60]

Another aspect of the isolation effect not mentioned above relates to cheating.[61] Because paying taxes is isolated from the outcome, it takes the sting off evasion. Recall the golf example in the Introduction, or consider the difference between downloading illegal music and running away from a

56. *See* Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision under Risk*, 47 ECONOMETRICA 263, 271, 274 (1979) ("In order to simplify the choice between alternatives, people often disregard components that the alternatives share, and focus on the components that distinguish them."); *see also* Amos Tversky, *Elimination by Aspects: A Theory of Choice*, 79 PSYCHOL. REV. 281, 281 (1972) ("When faced with a choice among several alternatives, people often experience uncertainty and experience inconsistency.").

57. Kahneman & Tversky, *supra* note 56, at 275.

58. *See infra* text accompanying notes 119 and 179.

59. *See* McCaffery & Baron, *supra* note 2, at 1786 (noting that the ordinary citizen focuses on what is in front of him or her, rather than public finance issues).

60. *Contra* McCaffery & Baron, *supra* note 2, at 1780 (In sum, we found no support for two hypotheses about why the "starve-the-beast" strategy might gain political support. People do not favor deficits, even in the short-term. Nor are people naively optimistic that deficits today will somehow disappear tomorrow. We found strong support, however, for a third hypothesis: People favor spending cuts in general but not in particular. The "starve-the-beast" strategy can work—in the sense of getting subjects to support policies of tax cuts today that they would not otherwise support—*by separating out decisions about tax and spending, making the former concrete while keeping the latter abstract, thereby generating the conditions for an isolation effect to take hold*.)
(emphasis added).

61. *See generally* Ariely, *supra* note 6, at 254 (describing the forces that drive dishonest behavior).

restaurant without paying for the meal. Both acts are illegal and both offenses are easy enough to perpetrate. Nevertheless, the first illegal act is much more common. The main reason is not the probability of being caught (it is hard to catch both offenders), but peoples' sense of guilt. The distance between the act and the injured party plays a major role. Individuals feel closer to the restaurant crew where they have just eaten rather than to the unknown copyright owner. When we combine this effect with the identifiable victim effect regarding taxation, it reinforces our conclusion that taxpayers cannot sense the direct consequence of evading tax because the outcome is too remote.

IV. EXPERIMENTAL STUDIES ON THE CORRELATION BETWEEN TAX AND RETURN

This conclusion finds support in experimental studies that find a correlation between tax and return. Some research on tax compliance does not focus just on fairness or moral rules,[62] but on our sixth reasoning–taxpayers perception of government spending and policy.[63] In general, tax compliance increases the more taxpayers agree with government policy. In a 1992 laboratory experiment on taxpayer reactions to diverse policy changes, Alm et al.[64] had students take part in an unknown number of sessions.[65] Each received randomly assigned tokens ("income") and had to decide how many to declare. Some information was revealed to the participants, such as the tax rate, the fact that unreported income was not taxed, the probability of audit, and the fine for unreported income. An audit was performed randomly and brought to the participants' attention. In another session, participants were introduced to a public good. Their tax payments were then distributed equally among the participants. In other

62. *See* discussion *supra* Section III.

63. *See, e.g.*, Andreoni et al., *supra* note 18, at 850 ("[W]e discuss how taxpayer evaluations of government expenditures and government corruption might influence compliance.").

64. *See* James Alm et al., *Estimating the Determinants of Taxpayer Compliance with Experimental Data*, 45 NAT'L TAX J. 107 (1992) (discussing how compliance with taxpayer reporting changes based on audit, penalty, and tax rates); *see also* Kent W. Smith, *Reciprocity and Fairness: Positive Incentives for Tax Compliance*, *Introduction* to WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT 223 (Joel Slemrod ed., 1992), referred to in Andreoni et al., *supra* note 18, at 851 (describing empirical studies examining strategies to effect tax compliance); Michael W. Spicer & S.B. Lundstedt, *Understanding Tax Evasion*, 31 PUB. FIN. 295 (1976) (noting that empirical research shows that norms influence taxpayers' compliance).

65. For a more detailed description of the experiment, *see* Alm et al., *supra* note 64, at 108-09.

sessions, some other changes were made.[66] Although this model is somewhat artificial and has its drawbacks,[67] it has also led to some interesting findings. In particular, research revealed: "[c]ompliance is also greater when the individuals perceive some benefits from a public good funded by their tax payments."[68]

In a later study, Alm et al.[69] examined whether tax compliance was affected by government expenditures. They found that tax compliance significantly increased when taxpayers had some control over the use of their payments and government programs received broad popular support. The correlation between tax compliance and government expenditures did not receive much attention in the literature until recently.[70] Cowell and Gordon[71] have tested this correlation and claim that "while the government taketh away, it also giveth back, and the latter activity surely exerts some influence on evasion."[72] Bordignon claims that taxpayers' decisions to evade depend on their perception of fairness, where tax structure, government expenditure, and free rider taxpayers establish fairness.[73]

Barone and Mocetti, who also refer to Alm et al., empirically study the position of the public sector (in Italy) in shaping individuals' tax morale (they do not examine the influence on tax compliance, among other things, since it is very difficult to measure).[74] Their research focuses on individual attitudes towards municipalities' performance.[75] In general, they find a negative correlation between low (municipal) tax morale and inefficient

66. *Id*. at 108-09.

67. *Id*. at 112 (discussing the deficiencies of the model).

68. *Id*. at 112.

69. Alm et al., *supra* note 28.

70. Christopher Robert Jones, Understanding and Improving Use-Tax Compliance: A Theory of Planned Behavior Approach (July 9, 2009) 28 (unpublished Ph.D. dissertation, University of Southern Florida) ("Interestingly, little tax research has examined this obvious point."); *see also* Guglielmo Barone & Sauro Mocetti, *Tax Morale and Public Spending Inefficiency*, 18 INT'L TAX & PUB. FIN. 724, 726-27 (2011) ("Most of these studies analyses [sic] how individual socioeconomic characteristics affect tax morale, whereas the evidence on the role of institutions is scant.").

71. Cowell and Gordon clarify the relationship between tax evasion and public expenditure by treating public good as one ingredient in the taxpayer portfolio choice. Frank A. Cowell & James P.F. Gordon, *Unwillingness to Pay: Tax Evasion and Public Good Provision*, 36 J. PUB. ECON. 305 (1988).

72. *Id*. at 305.

73. Massimo Bordignon, *A Fairness Approach to Income Tax Evasion*, 52 J. PUB. ECON. 345, 346 (1993) ("[W]e rationalize the ethical norms supporting compliance by making them dependent on tax structure, public expenditure and perceived evasion by other taxpayers.").

74. *See* Barone & Mocetti, *supra* note 70, at 725 (discussing the public sector generally and its effects on tax morale).

75. *See, e.g.*, *id*. at 729 (discussing the local public spending inefficiencies).

allocation of public funds.[76] The negative effect of inefficiency increases if spending is lower or fiscal independence is higher.[77] Their explanation for this phenomenon is that first, taxpayers are more aware of how revenue is allocated and spent;[78] and second, "[g]reater autonomy of local authorities, in turn, increases the proximity between the taxpayer and the public sector so that citizens assign more responsibilities to municipalities and are more responsive to their spending efficiency."[79] Like Alm et al., the authors believe that tax morale is higher if taxpayers "see more benefits in return for their tax contributions."[80]

Torgler et al., set out:

> to evaluate the impact of voter participation on tax amnesties conducting a laboratory experiment. The results of our experiment show that the mere possibility for taxpayers to decide on a tax amnesty increases future tax compliance. It seems that the voting procedure, especially public discussions prior to votes, is bringing *about a sense of civic duty, as taxpayers become aware of the importance to contribute to public goods*.[81]

They concluded that "tax compliance increases significantly when people have the opportunity to vote on a tax amnesty. The strongest effect can be achieved when the voting procedure is coupled with pre-voting discussion."[82]

Bird, Martinez-Vazquez & Torgler[83] empirically examine the tax level in various developing countries. It is interesting to see that their data do not focus only on the supply side but also on the demand side. They take into consideration factors such as "institutions, the size of the shadow economy, wealth inequality and 'tax morale'".[84] They believe that "[i]f taxpayers perceive that their interests (preferences) are properly represented in political institutions and they receive an increased supply of public goods, their willingness to contribute increases."[85]

In a laboratory experiment Falsetta et al.[86] examine the correlation

76. *See, e.g.*, *id*. at 725 (examining "whether taxpayers living in municipalities where public spending is more inefficient show lower tax morale.").

77. *Id*. at 726.

78. *Id*.

79. *Id*.

80. *Id*. at 741.

81. Torgler et al., *supra* note 21, at 377.

82. *Id*. at 392.

83. Richard M. Bird, Jorge Martinez-Vazquez & Benno Torgler, *Societal Institutions and Tax Effort in Developing Countries*, CREMA Working Paper No. 2004-21.

84. *Id*. at 3.

85. *Id*. at 3, 16.

86. Diana Falsetta, and Jennifer Kahle Schafer & George T. Tsakumis, Tax Evasion: Audit Probability and the Moderating Role of Goal Conflict (Jan. 28, 2010) (unpublished

between tax evasion and goal conflicts. They find that taxpayers tend to pay more taxes when they support government programs. They focus on the use of taxes and how the collected taxes are spent and cause conflicting interests.[87] They analogize it to the agency problem and claim that when there is conflict of interests, taxpayers (agents) will tend to pay less tax to the "tax collecting agency"[88] (principal).[89] Their suggestion is very significant to this paper since they recommend that "tax researchers and policy makers should investigate ways to better align the goals of the taxpayer and the government to increase tax compliance."[90]

Jones[91] examines empirically whether tax compliance differs between various taxes.[92] The taxes at stake are federal income tax and a certain state consumption tax (the use tax).[93] It seems that although many scholars have examined mechanisms to induce tax compliance in the US, they focus on federal taxes.[94] He finds a positive correlation between, inter alia, the "salient beliefs effort"[95] and funding for the state and tax fairness[96] – the prevalent factors in taxpayer decisions to pay the use tax or not.[97] We believe that the main contribution of Jones's paper lies in pinpointing the specific tax.

In a recent study highly relevant to our discussion, Li et al.[98] ask why people tend to donate money to private organizations even while complaining about their high tax burden. Using "real-donation" laboratory experiments,[99] they show that even though individuals donate also to public organizations, they prefer donating to private ones since they favor voluntary payments and control over the use of their money.[100]

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manuscript) (on file with author).

87. *Id*. at 1 note 1, and at 6.

88. *Id*. at 6.

89. *Id*. at 2, 8.

90. *Id*. at 2, 16-17. For the limitations of their model *see id*. at 17-18.

91. Jones, *supra* note 70.

92. For the limitation of this study see Jones himself, *supra* note 70, at 68.

93. The use tax is a kind of excise tax imposed by some states. It is levied on personal products purchased by a resident of the state outside of his residence (for example, via internet) that would have been taxed had they been purchased within the residence state.

94. Jones, *supra* note 70, at 2; *see also* Kornhauser, *Tax Morale Approach*, *supra* note 21, at 632 (proposing that politicians emphasize not just the tax burden but rather "the benefits of taxation, or the fact that tax burdens are relatively low both historically and relative to other nations. They often talk about taxes generally without differentiating between federal taxes and state/local taxes.").

95. Jones, *supra* note 70, at 28.

96. *Id*. at 65.

97. *Id*.

98. Li et al., *supra* note 34.

99. *Id*. at 1191.

100. In a subsequent study they find that when the targeted donation is specific, not only

V. WHAT IS TAX?

Several mathematical and empirical studies on tax compliance are limited,[101] mainly because they are inflationary, or refer to a specific regime, using the term "tax" even when referring to other compulsory payments. They indicate that there is a certain correlation between compulsory payments and public goods; indeed, it makes sense that if a person can see a return to his payment it encourages him to pay his share. However, to some extent they misconceive taxation. Some do not share the same concept of tax and may lack one significant element, which is the nature and differentiation of taxation. For example, can we deduce the same conclusion from municipal payments and federal taxes? Some studies refer to public goods though they treat them more like private goods – if you pay you will get a direct return. However, this is absolutely not what taxes stand for in civil societies. For this reason, it is important to first determine what tax is.

Although just as certain as death, taxes are not simple to define. Black's law defines tax as:

> A charge, usu. monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue. Most broadly, the term embraces all governmental impositions on the person, property, privileges, occupations, and enjoyment of the people, and includes duties, imposts, and excises.[102]

Referring to all charges as taxes may be misleading since federal taxes are also and perhaps mainly characterized by an important variable not included in the above definition – quid pro quo. The OECD definition is as follows:

> Taxes are compulsory, unrequited payments, in cash or in kind, made by institutional units[103] to government units;[104] they are

do taxpayers prefer government donations to private ones but also double their donated amount. Sherry Xin Li et al., Do Earmarks Increase Giving to Government? (Oct. 16, 2011), http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.415.2207 [https://perma.cc/M2C6-KVSL].

101. Kornhauser, *Tax Morale Approach*, *supra* note 21, at 605. Mathematical models are usually based on some unrealistic assumptions. *Id*. Empirical and particularly laboratory studies on tax compliance are somewhat artificial and cannot accurately represent reality. *Id*. at 605-06. In addition, any finding cannot be conclusive since it depends, inter alia, on the sample and procedure characteristics. *Id*.

102. BLACK'S LAW DICTIONARY (10th ed. 2014).

103. Institutional unit is defined in OECD, Glossary Statistical Terms, SNA 4.2, http://stats.oecd.org/glossary/detail.asp?ID=1413 [https://perma.cc/2CRV-L3S9], as:

[A]n economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities. . . . The resident

> described as *unrequited* because the government provides nothing in return to the individual unit making the payment, although governments may use the funds raised in taxes to provide goods or services to other units, either individually or collectively, or to the community as a whole.[105]

Another definition in the same vein is that tax is "[a] compulsory levy made by public authorities for which nothing is received *directly* in return."[106]

In general, tax has three components: first, it is levied by the government in a law; second, it is compulsory; and third, *it is not directly correlated to the benefits provided by the government*.[107] More concisely and elegantly put, "[a] tax is commonly defined as a compulsory levy by the government on people's income or wealth without a direct *quid pro quo*."[108] The third criterion is the most significant for our current purposes.[109]

institutional units that make up the total economy are grouped into five mutually exclusive sectors: non-financial corporations; financial corporations; general government; non-profit institutions serving households; households.

104. Government units are defined in OECD, Glossary Statistical Terms, SNA 4.104 [4.19], http://stats.oecd.org/glossary/detail.asp?ID=1140 [https://perma.cc/4HXF-FRFH], as: "unique kinds of legal entities established by political processes which have legislative, judicial or executive authority over other institutional units within a given area."

105. OECD, Glossary Statistical Terms, Taxes. SNA 7.48 [8.43], http://stats.oecd.org/glossary/detail.asp?ID=2657 [https://perma.cc/76MJ-BT8Q] (emphasis added).

106. Simon R. James, A DICTIONARY OF TAXATION, 142 (1998).

107. Victor Thuronyi, *Tax*, *in* TAXATION & TAX POLICY 375 (Joseph J. Cordes et al. eds., 2005).

108. Young-dahl Song & Tinsley E. Yarbrough, *Tax Ethics and Taxpayer Attitudes: A Survey*, 38 PUB. ADMIN. REV. 442, 442 (1978).

109. *See* OECD, *Definition of Taxes*, para III.9 (1996), http://www1.oecd.org/daf/mai/pdf/eg2/eg2963e.pdf [https://perma.cc/ZBE4-6L28] (not all compulsory payments are taxes. These non-tax compulsory payments can be fees, user charges, and tolls. The OECD indicates that occasionally it is difficult to decide whether a certain compulsory payment should be considered as tax or not.); *see also* OECD, *Definition of Taxes*, *Id*. para III.9 (fees and charges are usually levied in return for a certain government service). However, sometimes the association between the compulsory payment and the service provided is rather loose. Therefore, the OECD set guidelines to examine whether "a levy could be considered as 'unrequited.'" *Id*., para III.9(a) (one indicator is when the compulsory payment largely exceeds the costs of the service); *id*., para III.9(b).

VI. ANALYSIS BASED ON THE INTRINSIC FLAW OF TAXATION

A. *General*

Following our definition of tax and discussion of individual cognitive biases, we may conclude that an intrinsic flaw of taxation is the perceived remoteness of tax payments from government actions.

In order to promote tax compliance one has to comprehend the deliberation process leading up to the taxpayer's decision to evade.[110] To do so, it would be insufficient to address the concept of behavioral economics in general terms; we have to specifically tackle taxpayer cognitive biases. This paper suggests two cognitive biases: the identifiable victim effect and "short-term biases" that may affect taxpayer decisions whether to evade tax. This means we cannot provide only one general recommendation. In a similar vein, albeit in the slightly different context of whistleblowing, Feldman and Lobel argue that "there is no one-size-fits-all solution for policy design. Rather, policy makers must consider the characteristics of the target population of social enforcers and incentivize them accordingly."[111]

Through the current examination of one specific behavioral problem, we are actually discussing a broader, more profound question in tax discourse. Not only do we have to understand human nature but we also have to understand the nature of taxation itself before we can recommend mechanisms to enhance compliance. The problems of tax compliance (especially the underreporting and underpayment problems) are not merely due to the fact that tax is a compulsory payment. Many experimental studies examine its compulsory payment component.[112] Tax is characterized also by the lack of direct correlation between payments and returns. There is sufficient quantitative data confirming there is a correlation between compliance and government spending, as broadly discussed in Section V. Thus, *the perceived remoteness of the compulsory payment from its benefit* (*Type II agency problem*)*, in addition to taxpayer cognitive biases, is critical to any compliance discussion*.

What if the government should inform taxpaying parents, for example, that their money is spent on education? Or taxpayers with dependent

110. *See generally* Jones, *supra* note 70, at 3 ("[A]n important first step in improving use-tax compliance is to identify factors associated with the use-tax compliance decision.").

111. *See* Feldman & Lobel, *supra* note 1, at 1156; *see also id*. at 1207 ("An important implication of the study is that no one-size-fits-all policy design exists, but rather, policy makers must evaluate the full scope of psychological and situational factors in order to design the most efficient incentive structures.").

112. Li et al., *supra* note 34.

relatives that their taxes go to a health program? Or veterans that their taxes are directed to the armed forces? Such information could align taxpayer interests with the government's and enhance compliance, although it is also plausible to assume that even taxpayers without children or disabled relatives would be more willing to pay if they know their money is spent on education and health, or any other program they believe in or support. This idea follows the Listokin & Schizer's proposition that if taxpayers could support the way their taxes were spent the tax would be more effective.[113] After specifying the cognitive biases in the paper, it seems this kind of information (related to the Type II agency problem) could align taxpayer interests with government interests and enhance compliance, providing the missing link between the agent (taxpayers) and the principal (the government) (Type I agency problem).

B. *A Normative Principle for Tax Allocation: The De Jure Benefit Principle and Wicksell's Connection*

The scenario just presented an idealized setting in which taxpayers can choose which program or authority they wish to fund. This idea bears some similarities to the benefit principle.[114] It is not a de facto benefit, but rather a de jure benefit, which does not undermine equitable objectives. The benefit principle means that taxation will be levied in accordance with the benefit taxpayers receive from consuming public goods.[115] The idea is that public goods and services are supplied in the market and traded just like any other product.[116] In that respect, tax is analogized to a price paid for public goods and services. In other words, the tax is paid in return for the benefits the taxpayer receives from the government. Although the benefit principle was widely criticized in the literature, mainly since it supports private property at the expense of redistribution,[117] this weakness is irrelevant for our current purposes since we are referring to the de jure benefit – how people *perceive* that their taxes are utilized. Nevertheless, another criticism raised against the benefit principle, which is relevant here, is that government expenditure would depend on taxpayers' preferences.[118]

This idea also bears some similarities to "Wicksellian Connection,"[119]

113. Listokin & Schizer, *supra* note 4, at 179-80.

114. Slemrod & Bakija, *supra* note 15, at 61-66.

115. *Id*. at 62.

116. *Id*.

117. *Id*. at 63-64.

118. John G. Head, *Tax-Fairness Principles: A Conceptual, Historical, and Practical Review*, *in* FAIRNESS IN TAXATION 3, 7-8 (Allan M. Maslove ed. 1993); *see also* Slemrod & Bakija, *supra* note 15, at 63-64.

119. As termed by Albert Brenton, COMPETITIVE GOVERNMENTS: AN ECONOMIC THEORY

an approach which deserves a much more thorough elaboration elsewhere. The alignment discussion here is partly compatible with the Wicksellian approach to expenditures and revenues.[120] Wicksell claims "the theory of Value and Countervalue had at least the virtue of maintaining some sort of contact with the other, the expenditure, side of the public economy."[121] In other words, the benefit principle should be applied "on both sides."[122] The reason is that only this principle can maintain "some sort of contact with the other, the expenditure, side of the public economy."[123] He argues that a just and efficient tax system does not focus merely on revenue but at the same time on expenditure, and that tax systems should enable taxpayers to direct their payments via a rule of unanimity.[124] This recommendation, however, is designed to promote efficiency and justice and not necessarily compliance.

More recently, Levmore[125] demonstrates that in many instances taxes serve as ballots (such as charitable deductions) that enhance the social choice mechanism. Levmore thus discusses "Taxes as Ballots" not as a means to increase tax compliance, but rather as a tool supporting public choice and the democratic process.[126]

Relatively few contemporary scholars see, as Bird claims, the importance of connecting both sides of the budget.[127] The link between revenue and expenditure has long been neglected. Bird supports the

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OF POLITICS AND PUBLIC FINANCE 3 (1996).

120. *See generally* Breton, *supra* note 119, at 3, 23-24 ("[I]f collective decisions about expenditures and revenues are made simultaneously and unanimously, a connection or link between costs and benefits . . . will be forged . . . and utility losses will be equal to zero."); James M. Buchanan, *The Pure Theory of Government Finance, a Suggested Approach*, 57 J. POL. ECON. 496, 497 (1949) (asserting that "[t]he maximizing process consists of simultaneous determination of all the variables on both sides." (*i.e.*, expenditure and tax variables)); Richard E. Wagner & Knut Wicksell, *Contemporary Political Economy*, *in* HANDBOOK OF THE HISTORY OF ECONOMIC THOUGHT: INSIGHT ON THE FOUNDERS OF MODERN ECONOMICS 523-24 (Jürgen George Backhaus ed., 2012) (describing the Wicksellian approach to public finance); Knut Wicksell, *A New Principle of Just Taxation*, *in* CLASSICS IN THE THEORY OF PUBLIC FINANCE 72 (Richard A. Musgrave & Alan T. Peacock, eds., 1958) (arguing for taxation according to benefit).

121. Wicksell, *supra* note 120, at 74.

122. *Id*. at 72.

123. *Id*. at 74.

124. *See, e.g*., Head, *supra* note 118, at 9 (due to differential tax burdens we do not necessarily support the unanimity rule designed to represent as accurately as possible taxpayers' willingness to pay for public products and services; *see also* Richard A. Musgrave, THE THEORY OF PUBLIC FINANCE 71-72 (McGraw-Hill, 1959) (interpreting the approximate unanimity rule).

125. Saul Levmore, *Taxes as Ballots*, 65 U. CHI. L. REV. 387 (1998).

126. *Id*. at 391-92, 425-26.

127. Richard M. Bird, *Evaluating Public Expenditures – Does it Matter How They are Financed?*, *in* FISCAL MANAGEMENT 83 (Anwar Shah ed., 2005).

revenue-expenditure link and considers it "an essential institutional feature."[128] Such a link has the power to reveal people's preferences and increase their participation in the democratic state (as Levmore claims).[129] One way to achieve it is by decentralization—where tax payments are more closely aligned with local government expenditures.[130] According to Bird, "[m]uch more attention should be paid to links between expenditures and revenues than has been the rule to date in applied economic analysis of the public sector."[131]

We suggest activating the Wicksellian connection[132] without undermining the equitable principle of raising revenue (the revenue side), and at the same time without any significant interfering with the expenditure side. Raising revenue would generally follow the ability-to-pay notion; this paper suggests no change in the revenue side of the equation. On the contrary, taxpayers who may face noncompliance compulsion due to the distance between payments and outcome would be able to choose how to direct their funds (without transforming the tax system). This ability to choose is defined here as the *de jure benefit principle*.

C. *Proposal for Enhancing Tax Compliance – General*

Throughout the years scholars have been preoccupied with mechanisms for enhancing tax compliance.[133] Listokin and Schizer, for example, offer some mechanisms which may overcome either the compulsory aspect of taxation or the remoteness between payment and the outcome,[134] such as publicizing government action,[135] avoiding government waste,[136] expanding user fees and increasing the local government's role in

128. *Id*. at 95.
129. *Id*. at 96.
130. *Id*. at 96.
131. *Id*. at 100 (Bird elaborates on some possible links such as using user charges, specific benefit taxes, and local taxes).
132. *See, e.g.*, *id*. at 101.
133. *See supra* Section III.
134. Listokin & Schizer, *supra* note 4, at 193-204.
135. *See* Gary M. Lucas, *Out of Sight, out of Mind: How Opportunity Cost Neglect Undermines Democracy*, 9 N.Y.U. J. L. & LIBERTY 249, 322-325 (2015) (stating that this technique of increasing the visibility of government benefits may suffer from some flaws. It has the power to misrepresent government achievements and spending and also neglect programs' opportunity costs).
136. *See* Listokin & Schizer, *supra* note 4, at 196-98 (governmental waste is open to interpretation, however. One person may consider a certain activity wasteful while the other may consider it worthwhile).

tax collection.[137] In general, these mechanisms may be able to increase tax compliance, but they suffer from some flaws, as the authors acknowledge. The main problem of those mechanisms is not only that they might interfere with the tax system and with government sovereignty (the expenditure side), but more severely, that some of them are mainly aimed at increasing tax compliance effectiveness without seeking to maintain equitable tax collection. For example, user fees are motivated by the benefit principle but not by taxpayer's ability to pay.[138]

For the sake of discussion, let us focus on one possible taxpayer preference: stopping military spending. Pacifists claim that the moral right not to take active part in wars also includes the right not to finance wars by paying taxes.[139] This idea is rooted in American history,[140] and is currently championed by NPOs such as the National Campaign for a Peace Tax Fund (NCPTF),[141] which campaigns for a law to enable conscientious objectors to direct their taxes to a trust fund dedicated to non-military goals.[142]

The first peace tax bill was introduced in the American Congress in 1958[143] and amended and reintroduced several times since.[144] The bill was

137. But see Li et al., *supra* note 34, at 1199, for the argument that people prefer national to local projects.

138. Listokin and Schizer, *supra* note 4, at 200-201. The current paper bears some similarities to Listokin and Schizer's paper, but differs in many facets. First, this paper focuses only on the intrinsic flaw of taxation whereby taxpayers are unable to see the outcome of their tax payments, whereas Listokin and Schizer also refer to taxation as compulsory payment. Thus, their analogy to donations is thought-provoking but irrelevant to the current discussion. This paper eliminates the compulsory aspect of taxation from the discussion. Second, this paper points out the specific cognitive biases that lead to taxpayers' misunderstanding of tax evasion. Third, Listokin and Schizer's suggestion has tremendous implications for the tax system: they suggest reorganizing the system by interfering with government sovereignty. This paper is more modest in its implications, and although its recommendation has the power to increase tax compliance it is more of a semantic tool that hardly interferes with the current system. Thus, it focuses exclusively on tax systems that do not fully apply voluntary tax compliance mechanism. Finally, and most importantly, Listokin and Schizer emphasize the effectiveness of tax compliance even when it may have non-equitable consequences. This paper, on the other hand, stresses the equity principle and offers an application that does not undermine it by demonstrating the applicability of a normative principle that both maintains equity and enhances compliance.

139. Marjorie E. Kornhauser, *For God and Country: Taxing Conscience*, 1999 WIS. L. REV. 939, 941 (1999).

140. For a more detailed historical overview, *see* Kornhauser, *supra* note 139, at 946-81.

141. *Welcome to the National Campaign for a Peace Tax Fund*, NATIONAL CAMPAIGN FOR A PEACE TAX FUND, http://www.peacetaxfund.org/ [https://perma.cc/TFL3-2YMD] (last updated Jan. 26, 2016).

142. For a partial list of organizations supporting conscientious objection, *see* Kornhauser, *supra* note 139, at 955. For the differences between them, see *id*. at 957-58.

143. H.R. 12310, 85th Cong. (1958) as mentioned in Kornhauser, *supra* note 139, at 985.

reintroduced in 2015,[145] with the aim of affirming "the religious freedom of taxpayers who are conscientiously opposed to participation in war, to provide that the income, estate, or gift tax payments of such taxpayers be used for nonmilitary purposes, to create the Religious Freedom Peace Tax Fund to receive such tax payments, to improve revenue collection, and for other purposes."[146]

Briefly, this project has two major problems. First, it limits government sovereignty and interferes with its discretionary authority to spend public funds;[147] second, and more relevant for our purposes, it limits itself only to one dimension of public spending. Thus, it may increase tax compliance among peace activists,[148] but not necessarily among supporters of other laudable, non-military goals such as education or health. The behavioral economic literature suggests additional weaknesses of that model, such that this conduct could be contagious and reduce overall compliance,[149] but this exceeds the scope of the present discussion.

The proposal of this paper goes two steps beyond the NCPTF concept; it is mainly relevant to jurisdictions that do not fully apply voluntary tax compliance (tax assessment method) and differs from Listokin and Schizer's paper.[150] The American system and partly the Canadian[151] and the Australian systems[152] are considered voluntary systems since the first

144. Kornhauser, *supra* note 139, at 986-89.

145. The Religious Freedom Peace Tax Fund Bill, H.R. 2377, NATIONAL CAMPAIGN FOR A PEACE TAX FUND (May 15, 2015), http://www.peacetaxfund.org/thebill/ [https://perma.cc/GUL8-Q3W4].

146. H.R. 2483, 113th Cong. (2013-2014), https://www.congress.gov/bill/113th-congress/house-bill/2483/text?format=txt [https://perma.cc/PRX6-BLLW].

147. For a different view, *see* Kornhauser, *supra* note 139 (supporting the idea of a peace tax fund because war tax protesters should not be treated similarly to other tax protesters since the former do not threaten the legal system's legitimacy).

148. *Id*. at 945, 1011-15.

149. Kornhauser rejects this criticism in *For God and Country*, *supra* note 139, at 990.

150. Note, however, that Listokin and Schizer suggest a more comprehensive approach including also "allocating voluntary payments" in the US. Listokin & Schizer, *supra* note 4, at 204, 209-13.

151. Although the Canadian tax administration is based on voluntary compliance, it is not entirely voluntary since salaries are subject to withholding tax at source. *See* Hugh J. Ault & Brian J. Arnold, COMPARATIVE INCOME TAXATION – A STRUCTURAL ANALYSIS 36-37 (2010) (discussing methods employed by Canadian courts to control tax avaoidance). For individuals who have to lodge a tax return, *see* CANADA REVENUE AGENCY (Jan. 5, 2016), http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/ncm-tx/flng-blgtns/menu-eng.html [https://perma.cc/UL96-WHAT].

152. It is stated in the Australian Taxpayers' Charter that "[w]e prefer to work with you cooperatively, providing you with help to meet your obligations voluntarily." *Taxpayers' Charter – What you need to know*, AUSTL. GOV'T – AUST'L TAX'N OFF (https://www.ato.gov.au/printfriendly.aspx?url=/about-ato/about-us/in-detail/taxpayers--charter/taxpayers--charter---what-you-need-to-know/) [https://perma.cc/5SPJ-TMXA] (last

stage in tax collection is the tax assessment by the taxpayers themselves.[153] Nevertheless, there are jurisdictions in which not all (income) tax collection is voluntary. Countries such as Britain and to some extent Canada,[154] for example, implement withholding taxes on salaries, which compose a large portion of overall income taxation (if taxpayers do not reclaim tax refunds).[155] In this system, employers serve as government collectors and employees have no opportunity to evade taxes on their salaries. This is an effective mechanism to eliminate tax evasion. Another possible technique is to minimize cash flows in a country by increasing credit card payments to reduce the underground economy.[156] Nevertheless, there is no tax system that collects solely compulsory taxes.

Since taxes, by definition and contrary to other compulsory payments, are not aligned to the benefits a taxpayer receives in return, and since some taxes are collected voluntarily, the government has to endeavor to align taxes to taxpayers' preferences. Aligning taxes and tax compliance is mainly relevant to taxpayers required to file their returns. The solution this paper proposes is also inspired by Mazar, Amir and Ariely's study.[157] However, we do not propose to sign an honor code on the tax return, but rather let taxpayers choose which ministry, department or program they wish to finance. This proposal is similar to Listokin and Schizer's "allocating mandatory payments,"[158] though it is only relevant to countries that partly apply voluntary tax compliance. Apparently, it can be easily implemented by adding some checkboxes next to taxpayers' signature on the tax return for assigning taxes to preferable policies. If taxpayers receive more detailed choices, it will increase their motivation to comply.[159]

modified Jan. 5, 2016). A voluntary compliance program was launched in the 2010-11 Federal Budget to enhance compliance. During 2012 the program was extended for an additional three years. *GST Voluntary Compliance Research*, AUSTRALIAN TAX OFFICE, (Mar. 6, 2014), https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/general-research/gst-voluntary-compliance-research---phase-3-2013/ [https://perma.cc/3FZR-ZYKU].

153. Kornhauser, *supra* note 139, at 941 n.7.

154. *Supra* note 151.

155. The British law applies "The Pay As You Earn" (PAYE) system. *See* Income Tax (Earnings and Pensions) Act 2003 §§ 682-87; Income Tax (Employments) (Consolidated) Regulations, 2001 (S.I.No. 559 of 2001) § 28.

156. For a report on the shadow economy in Europe and the effectiveness of credit cards in mitigating the problem, *see* Friedrich Schneider, Ph.D., *The Shadow Economy in Europe*, VISA 1 (2013), https://www.visaeurope.com/media/pdf/the%20shadow%20economy%20in%20europe%202013.pdf [https://perma.cc/ZAS4-J92U].

157. Mazar, Amir & Ariely, *supra* note 3.

158. Listokin and Schizer, *supra* note 4, at 204, 212-15.

159. Nevertheless, in cases of massive organized cooperation by taxpayers prior to filing tax reports, a detailed choice mechanism can divert choices to one main policy. *Id.* at 208.

Naturally, this mechanism requires administrative arrangements to channel the dedicated funds. This mechanism will be able to overcome the biases outlined in the paper and the third component of the tax definition. Imagine that you check the "education" or "elementary education" box on your tax return; when you take your child to school in the morning you could tell your child: "Do you know that because mammy and daddy paid their taxes, the playground in your school was redecorated and now you and your friends can play there safely?"

Is the above scenario apocalyptic? We believe that following the foregoing analysis the proposal in this paper is feasible. Indeed, it has recently been echoed in a proposal raised in Oxfordshire County Council, England, to allow members of the community to voluntarily pay more taxes (i.e., donate to the local council) and choose which project they wish to fund.[160]

D. *Detailed Mechanism for Implementing the Proposal*

Changing the Tax Returns. As mentioned above, the mechanism required to implement the proposal is simply to add a checkbox in tax returns, letting taxpayers choose which ministry, department or program they wish to finance. Although it is quite straightforward to reprint the new tax returns this is naturally only the first step required by the government. In order to fully implement the proposal, the government has to set up an administrative mechanism to channel tax payments to the dedicated funds. Only a credible transparent procedure can serve this compliance goal, as elaborated below under *Transparency Requirements*.

Voluntary Tax System and Government Sovereignty. The mechanism presented here for aligning tax payments and public goods leads to an apparent deadlock. On the one hand, it enhances compliance, but on the other hand it seems unrealistic: even if we overcome the practical difficulties it involves, can any government afford to base its expenditure on taxpayer preferences? Could it plan ahead and carry out long-term policies? To some extent, as elaborated below, the idea is practicable if we assume a heterogeneous society. Assuming that the government follows on taxpayer choices (otherwise trust will be eroded and compliance rates

160. Income Generation Cabinet Advisory Group, *Notice of a Meeting*, OXFORDSHIRE COUNTY COUNCIL (Jan. 14, 2014), http://mycouncil.oxfordshire.gov.uk/documents/g4263/Public%20reports%20pack%20Tuesday%2014-Jan-2014%2012.30%20Income%20Generation%20Cabinet%20Advisory%20Group.pdf?T=10 [https://perma.cc/BRQ6-GYUA].

drop),[161] though, how could it function under such conditions? Assuming an extreme scenario where all taxpayers turn out to be environmentalists, for example, and all check the environment box, how could the government run the country?[162] Although this scenario is somewhat unlikely (since societies are not homogenous), clearly it would be impracticable for a tax system totally based on voluntary compliance.[163] In other countries, when voluntary compliance is partial and there are other efficient tax collection mechanisms (such as withholding taxes[164] and VAT),[165] the government can let taxpayers choose how to spend their income tax money and allocate the rest of its tax revenues according to its exclusive discretion.

A simple example will illuminate this point. Assume that the government equally allocates its resources between program X and program Y. Assume also that the population is equally divided between taxpayers who pay their taxes voluntarily via tax returns and taxpayers who pay their taxes non-voluntarily (thus having no opportunity to evade taxes) and that all taxpayers have the same ability to pay. If the taxpayers who pay voluntarily choose to finance only program X, the government will not need to change its policy and future programs since it will be able to allocate the taxes collected compulsorily to program Y. Thus, the government has enough latitude to fund its programs while still honoring taxpayer preferences and directing their taxes to the program they choose.

This latitude disappears if the government depends solely or mainly on voluntary tax compliance. In this case, the solution could be slightly different, though we do believe that the proposal is more suitable for a semi-voluntary tax compliance system. Taxpayer returns could still include checkboxes but in this case the tax returns should state that only a certain percentage would be directed to the programs selected. Naturally, this percentage depends on macro estimates and also slightly erodes the incentive to pay, but this solution is still better than no alignment at all.

161. We leave the discussion on the proper mechanism to maintaining this trust for future elaboration.

162. For a similar concern that taxpayers may feel more enthusiastic about one program and not the other, *see* Listokin and Schizer, *supra* note 4, at 206.

163. For a discussion on voluntary compliance, see the above discussion accompanying footnotes 151-154.

164. *See* the above text accompanying footnotes 154-155.

165. Because value-added tax is an input for one taxpayer and an output for another it is difficult for taxpayers to evade it. Because this tax is easy to enforce it is used worldwide (except for North America). *See* Slemrod & Bakija, *supra* note 15, at 195 (stating that the VAT is commonly used around the world, in part, because it is easy to administer and enforce).

Further, it was empirically observed that jurisdictions that collect VAT raise more taxes (albeit not significantly). Michael Keen & Ben Lockwood, *Is the VAT a Money Machine?*, 59 Nat'l Tax J. 905-28 (2006).

Following the previous example, we now assume that everyone has to file tax returns. If all taxpayers prefer program X, then the government will not be able to finance program Y. Although this scenario indicates the program's legitimacy and that of the democratic state (which is somewhat beyond the direct scope of this paper, but we will refer to it immediately below), if the tax return states that at least 50% of the taxes will be spent according to taxpayer preferences then the government could allocate its funds equally between programs X and Y, as before, without having to change its budget. We guess that the cynical among you say *pecunia non olet*.[166] We agree, but we believe that especially after discussing the specific cognitive biases we would like to know that our money is directly spent on programs we approve of, such as the school playgrounds.

Legal Quandaries. The proposed plan does not suggest that taxpayers choose how much tax to pay but rather how to spend their taxes. These choices are completely different from the legal perspective. Although in a democracy taxes are imposed only by law (see the above discussion on tax components),[167] some quandaries may arise in different jurisdictions if taxpayers can actually decide how to allocate the budget. This may raise some legal concerns that have to be resolved. Nevertheless, the current proposal suggests that taxpayers do not really affect the budget but merely feel their tax payments carry some weight.

Equity Issues. A possible grave quandary concerns taxpayer equality. Naturally, the government has to honor taxpayers' choices without violating other citizens' rights. The problem that can arise is that in any democratic election, each voter[168] has only one vote, whereas each taxpayer pays a different amount. Therefore, the government should be sensitive to taxpayers' wishes without letting some taxpayers have greater influence. Apparently, following the present proposal, taxpayers with higher ability to pay can be more influential on budget decisions and thus compromise the basic democratic concept that each person has only one vote.[169] Since the system is mainly applicable in a semi-voluntary compliance system and since we believe that after careful macro calculation it will not change government policy, the question is merely semantic. Normally, it really would not matter whether taxpayers have differential payment ability

166. In Latin, "money does not smell."

167. *See* Section VI.

168. For a discussion on using taxpayer as voters, *see* Levmore, *supra* note 125, at 388, who argues that "[t]he 'votes' cast through deductible contributions generate a measure of preferences that is in some ways superior and in other ways inferior to other polling devices."

169. This concern was also raised by Listokin and Schizer. Listokin & Schizer, *supra* note 4, at 208-09 (stating that "wealthy citizens are likely to have more personal influence on the overall allocation than low-income taxpayers.").

because each taxpayer payment is only a drop in the bucket. Nevertheless, it may have an adverse effect in extreme scenarios involving high-net-worth individuals. To prevent these individuals from disproportionately affecting budget decisions we can adopt either of two mechanisms. First, after macro calculation, we can state in the tax returns that each taxpayer is assumed to have the same ability to pay and his payments equal a certain quota. A simple example can illustrate this point. Assume there are only two taxpayers A and B, and that A is required to pay 20 and B 80. In this scenario the average ability to pay is 50, and each taxpayer is deemed to pay a 50 quota.[170] This means that if you are A, you will have even more incentive to pay since you can direct not only your tax share to a certain fund but also an additional 30. Note, however, that this would leave B with relatively less influence on the budget. The second mechanism can overcome this problem. Since the problem is relevant only to taxpayers with high net worth, we can impose a certain ceiling. This upper limit will restrict and prevent these individuals from having greater influence than the average taxpayer and maintain the equity principle.

Transparency Requirements. Finally, we would like to discuss the transparency issue. The model proposed here supports the public right to know how government collects and uses its taxes (which is one key aspect of transparency). As demonstrated here, this information is vital to tax compliance and to some extent, as elaborated above, important to democracy.[171] It gives the government an annual opportunity to receive taxpayer feedback and enables it to take their choices into account without compromising equality principles.[172] In that respect, it upholds the transparency principle.[173] To prevent information manipulation, it would be sufficient to specify how much was directed to health, education, etc. It is interesting to observe that some tax authorities, as in the United Kingdom,[174] are concerned with governmental transparency tax issues.[175] A

170. This solution does not take into considerations voters who for various reasons are excluded from paying taxes.

171. Listokin and Schizer also raise the problem of taxpayers who have to act on the basis of incomplete information. Listokin & Schizer, *supra* note 4, at 206-07 (stating that "we may worry that taxpayers will allocate money based on inexpert judgments and imperfect information, so that the results will diverge.").

172. For preserving equity issues see the discussion in the former paragraph. To achieve equality the paper does not necessarily support the unanimity rule discussed above under *supra* note 124.

173. *See* Bird, Martinez-Vazquez & Torgler, *supra* note 83, at 11-12 (supporting a transparent linkage between expenditure and revenue in discussing how to increase tax collection in developing countries).

174. And Australia. *See, e.g.*, *Australian Taxpayers' Charter*, *supra* note 152 ("To foster that confidence, we [Australian Tax Authorities] need to have a relationship with the community based on mutual trust and respect. We nurture that relationship by: being open,

survey made in the United Kingdom for HM Revenue & Customs reveals that taxpayers are more aware of bank account transactions than their tax payments and offers some recommendations to increase personal tax transparency.[176] One of the proposals that received support by more than half of the survey's participants was to receive a statement showing how payments "contribute to different areas of Government" spending.[177] This proposal is very interesting and can be viewed as the converse of the proposal set in this paper. However, while it may increase transparency, at the same time it can be counterproductive to tax compliance if a taxpayer believes that too much of his tax payments support a ministry or program he would rather not support. Recall, however, that our focus is on the other side of transparency—increasing the transparency of the expenditure (ex ante), not the revenue side (ex post).

Many scholars believe that lack of governmental transparency is associated mainly with corruption. The higher level of transparency according to these scholars means a lower level of corruption.[178] The idea is that transparency can tackle corruption since it overcomes the asymmetric information problem. The model suggested here facilitates a more transparent communication between government and taxpayers as already suggested by Wicksell.[179] Wicksell, for example, points to the importance of the press in informing taxpayers on the expenditure side.[180] In this paper, we suggest that in order to gain public trust the information should come directly from the government itself. The communication would be reciprocal in that it would both inform the government on taxpayer wishes and the latter on government actions. In order for the model to work and for people not to claim that *pecunia non olet*, governments also have to prove to taxpayers that their choices matter. One possible approach could be to require government to reveal cases in which it has honored taxpayer wishes but also those incidents in which it has disregarded them.

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transparent and accountable in our dealings with the community.").

175. Allison Christians, *Tax Secrecy and Transparency – The Relevance of Confidentiality in Tax Law Country Report: Canada*, *in* TAX SECRECY AND TRANSPARENCY: THE REVELANCE OF CONFIDENTIALITY IN TAX LAW, PART 1 AND 2 1 (Kristoffersson et al. eds. 2013).

176. *Personal Tax Transparency: Omnibus Survey Research – HM Revenue & Customs Research Report No. 177* 1, 4 (May, 2012), www.hmrc.gov.uk/research/report177.pdf [https://perma.cc/7Q9U-S63F].

177. *Id*. at 33-35.

178. *See, e.g.*, John A. Gardiner & Theodore R. Lyman, *The Logic of Corruption Control*, in POLITICAL CORRUPTION: A HANDBOOK (Arnold J. Heidenheimer et. al. eds., 1989).

179. *See supra* text accompanying note 119.

180. Wicksell, *supra* note 120, at 88.

The proposal here bears some similarity to Wicksell's connection though it is not identical. Wicksell believes that the benefit principle should apply on both sides. In this paper we do not focus on the revenue side but tackle only the tax compliance problem. Wicksell focuses on voluntary consent for tax payment, while this paper discusses seemingly voluntary consent on tax usage. Therefore, like Wicksell but for a different rational, we should endeavor to better inform taxpayers on the expenditure side to enhance tax compliance.

A more modest suggestion based on the rationale presented here would be to apply the checkbox scheme to specific tax forms, rather than to the main general tax returns,[181] where individuals have to declare only a specific income, mainly one that is difficult to monitor and enforce. For example, income related to cross-border transactions by a resident taxpayer.[182] Governments endeavor to induce taxpayers to disclose those incomes by various tools, such as voluntary disclosure and amnesties.[183] Since forms declaring such specific incomes are not submitted by all or even most taxpayers, there is no fear they would have inequitable effects or interfere with government sovereignty.

CONCLUSION

This article applies a bi-disciplinary approach to tax compliance, combining behavioral economic insights and tax discourse. In order to maximize compliance, it is insufficient to refer to behaviors in general – we need to specifically tackle taxpayers' cognitive biases. The paper focuses on two such biases and finds that taxpayers are largely indifferent to the distal damage caused by tax evasion (by virtue of the identifiable victim effect) and cannot properly process government expenditures (due to so-called "short-term" biases). The perceived remoteness of the compulsory payment from its benefit (Type II agency problem) is critical to any compliance discussion. The paper likens this discussion to a snowball, carrying down the slope the identifiable victim effect, the literature aligning taxpayers and public goods, the isolation effect and the fundamental nature of taxation. We do hope our discussion managed to stop that proverbial snowball and attain some order in the form of our practical

181. *See, e.g.*, Form 1040: Individual Income Tax Return, https://www.irs.gov/uac/About-Form-1040 [https://perma.cc/J3XK-P5V9].

182. *E.g.*, *Form 2555: Foreign Earned Income*, https://www.irs.gov/pub/irs-pdf/f2555.pdf [https://perma.cc/X55M-DNUY]; *Form 8588: Information Return for U.S. Person with Respect to Disregarded Entities*, https://www.irs.gov/pub/irs-pdf/i8858.pdf [https://perma.cc/X3X7-STY2].

183. For a discussion on the behavioral aspects of amnesties, *see* Torgler et al., *supra* note 21.

recommendation.

This paper discusses the *inherent flaw of taxation*—the unrequited payment—which impedes tax compliance. The solution proposed for this inherent flaw, which overcomes taxpayers' cognitive biases, is a *de jure benefit principle*, which means that while they do not pay directly for the public goods they consume, they do choose how the state would benefit from their taxes and allocate public goods, without interfering with the democratic order and state sovereignty. It allows taxpayers to choose which public good they wish to fund with their taxes, somewhat in line with the Wicksellian approach. This application is mainly suitable to tax systems which do not apply fully voluntary tax compliance.

The model proposed here supports the public's right to know how the government collects and uses its taxes, which is vital to tax compliance. It facilitates a more transparent communication between government and taxpayers as suggested by Wicksell, informing the government on taxpayer wishes and the latter on government actions (thereby solving both Type I and Type II agency problems). The elegance of this solution is that it does not interfere with equity criteria for tax collection, and ultimately does not violate equitable allocation of tax payments. Nevertheless, it has the power to overcome a specific tax compliance problem caused by the remoteness of tax payments from their use without impeding the equity perception of collecting tax (the revenue side) or transforming the tax system (the expenditure side).