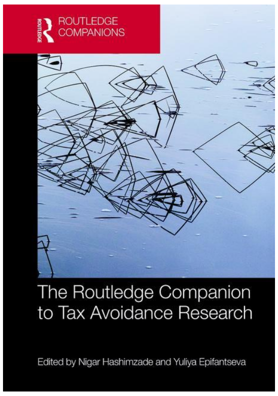

The Routledge Companion to Tax Avoidance Research

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Perspectives on the tax avoidance culture

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PERSPECTIVES ON THE TAX AVOIDANCE CULTURE

Legislative, administrative, and judicial ambiguity

Henry Ordower

Introduction to the culture of tax avoidance

During the latter half of the twentieth century, a robust tax planning industry emerged in the United States and much of Europe.[1] Tax planners took to heart Judge Learned Hand's admonition that "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."[2] They developed tax minimization products and sold them to high income and high wealth taxpayers. Most of the products focused on reducing taxpayers' exposure to the steeply progressive income taxes, but some products also reached similarly progressive estate and gift taxes. Less frequently planning addressed excise- and consumption-based taxes. Despite Judge Hand's tax-avoidance-favorable rhetoric, he took a purposive approach to tax planning. In holding for the government in *Helvering v. Gregory*, Hand grafted a corporate-business-purpose requirement onto the tax-deferred reorganization statute:

> But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the shareholders' taxes is not one of the transactions contemplated as corporate 'reorganizations.[3]

Yet, Judge Hand's endorsement of intentional tax structuring to diminish one's taxes continues to hold sway as a cultural precept.

1 H. Ordower, "The Culture of Tax Avoidance", 55 *Saint Louis University Law Journal* 47, 55–9 (2010) ("Ordower, Culture" in the following).

2 *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), aff'd. as *Gregory v. Helvering, 293 U.S. 465 (1935).* Judge Hand remained consistent about tax: "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." *Commissioner v. Newman*, 159 F.2d 848, 851 (2d Cir. 1947) (dissent).

3 Gregory, id., 811. Assaf Likhovski, "The Duke and The Lady: Helvering v. Gregory and the History of Tax Avoidance Adjudication", 25 *Cardozo Law Review* 953 (2004).

A tax law dictionary equates the concept of tax avoidance with tax planning resulting in minimization of taxes – a legitimate practice[4] – as contrasted with tax evasion – illegitimate tax diminution.[5] Tax planning that violates no law is neither illegal nor, from Judge Hand's perspective, reprehensible. Participants in the tax planning industry have been impressively creative. They have designed tax-efficient transactional structures to assist their clients in minimizing taxes and have enabled their clients to defer or avoid tax. The last two Republican Party presidential candidates engaged in substantial tax planning. Mitt Romney used the carried interest technique[6] and Donald Trump sustained a very large net operating loss[7] that may have been available to offset his income for tax purposes for as many as eighteen years. The tax loss probably came from leveraged investments.[8] Unknown is whether the disclosure that Romney used the carried interest technique to diminish his taxes or the disclosure of Trump's very large net operating loss and his unwillingness to disclose his tax returns had any impact on the outcome in the presidential elections.[9] Trump's victory suggests that American voters applaud those who avoid taxes.

Acceptance of tax avoidance and even some tax evasion[10] in the United States is commonplace. Much of the tax evasion is trivial – an individual finds a ten-dollar bill lying on the sidewalk and keeps it without including the amount in the income reported on the annual tax return.[11] Probably most Americans would either be unaware of the requirement to report the ten dollars or would agree that the amount is too small to be of any significance. Failure to report nevertheless is unlawful. The cultural demarcation between avoidance and evasion tends to blur as the rhetoric surrounding tax avoidance and evasion conflates the concepts. Absence of a sharp line between avoidance and evasion contributes to, or perhaps causes, growth in the "tax gap."[12] If one lacks the sophistication or the wealth for complex tax planning, exclusion

4 Richard A. Westin, *WG&L Tax Dictionary* (Valhalla, 2002), 784.

5 Id., 786.

6 Described under heading "Some examples of simple tax planning", Example 2 below.

7 Section 172 of the Internal Revenue Code of 1986, as amended (the "Code"), 26 U.S.C. A. §172, (the excess of operating deductions over income for tax purposes is a net operating loss). Taxpayers at the time of Trump's loss could carry the loss back three and forward 15 years as a tax deduction. Current rules allow a two year carryback and a twenty year carryforward under IRC §172(b)). This chapter will use IRC § followed by a number to refer to sections of the Code.

8 D. Barstow, S. Craig, R. Buettner and M. Twohey, "Donald Trump Tax Records Show He Could Have Avoided Taxes for Nearly Two Decades", The Times Found, *The New York Times* (1 October 2016), available at www.nytimes.com/2016/10/02/us/politics/donald-trump-taxes.html?_r=0. The information on Trump's tax reporting is scant, so the accuracy of the return remains in question. Whether the possible separation of the economic loss incurred by the lenders on the leveraged investments from the tax loss for Trump may have forced inclusion in Trump's income in a later year of an equal amount when the debt was discharged without payment is similarly uncertain, but Trump's creditors may have exchanged their debt for an equity interest in Trump's partnerships, thereby eliminating the cancellation of indebtedness income. D. Barstow, R. McIntire, P. Cohen, S. Craig and R. Buettner, "Donald Trump Used Legally Dubious Method to Avoid Paying Taxes", *The New York Times* (31 October 2016), available at www.nytimes.com/2016/11/01/us/politics/donald-trump-tax.html?emc=edit_na_20161031&nlid=54282593&ref=cta&_r=1.

9 Presidential candidates have no legal obligation to disclose their tax return, but disclosure has been customary since 1970. Tax Analysts, "Tax History Project: Presidential Tax Returns" (available at www.taxhistory.org/www/website.nsf/web/presidentialtaxreturns).

10 See discussion under heading "Some examples of simple tax planning", Example 4: Sales and Use Tax.

11 I.R.C. §61 includes "all income from whatever source derived" so that the ten dollars is includable.

12 "Tax gap" refers to revenue lost as a result of taxpayers' failure to report accurately and completely, as opposed to "tax expenditures," which refers to features of the tax law that enable taxpayers to reduce their tax liability. See discussion of the tax gap below under heading "Tax gap and the tax avoidance culture" and tax expenditures, see also *infra* note 30 and accompanying text.

from planning opportunities well may serve to justify self-help to level the playing field just a bit with small-scale evasion. The individual who finds the ten-dollar bill and knows she should report the income does not report.

Troubling recent disclosures from the Panama Papers[13] that many politicians and other public figures invested offshore through opaque entities imply questionable behavior resulting in both legal and possibly unlawful tax structuring. Some politicians inevitably express their outrage in light of such disclosures. Resulting rhetoric may link loss of tax revenue to legitimate tax planning and indiscriminately mix tax avoidance with tax evasion by assigning negative connotations to legally acceptable tax avoidance. In a recent interview about the Panama Papers, the Australian assistant finance minister stated, "[I]f people are deliberately structuring their affairs to avoid paying tax in Australia that is clearly against the law."[14] While the statement was political, a rhetorical device to introduce criticism of the predecessor Labor government's failure to address tax planning adequately, the assistant finance minister used the term "tax avoidance" pejoratively and probably incorrectly. Even as the interviewer focused on the legitimacy of the practice, the finance minister emphasized the need for stronger anti-avoidance (not anti-evasion) legislation. On the other hand, when Hillary Clinton, the Democratic Party presidential candidate, suggested that perhaps Donald Trump was not paying taxes, Trump retorted, "That makes me smart."[15] Trump seemed to justify his nonpayment of taxes when Clinton remarked on failing US infrastructure because Trump does not pay taxes by saying, "It would be squandered, too, believe me."[16] Trump's rhetoric supports tax avoidance and possibly even tax evasion as he argues that the government wastes the tax revenue it gets. Implicit is the observation that smart taxpayers avoid – perhaps even evade – federal income taxes since only foolish taxpayers give the revenue to the government.[17]

Whether one views tax planning as a legitimate or improper activity, tax planning has become embedded into the economic culture.[18] In many places, tax avoidance has taken on a life of its own as the growing number of enactments of general anti-avoidance rules (GAARs) evidences.[19] Successful tax planning may make an investment profitable when the investment would have

13 The International Consortium of Investigative Journalists, "The Panama Papers: Politicians, Criminal and the Rogue Industry That Hides Their Cash", available at https://panamapapers.icij.org/ (describing the findings of leaked papers from a major Panamanian law firm representing business and investment interests worldwide).

14 Leigh Sales interview of Kelly O'Dwyer, "Assistant Treasurer Says Australia Cracking Down on Tax Avoidance and Evasion", 2016 WTD 66-21 (Release Date: APRIL 04, 2016) (Doc 2016–7195) (available at https://advance.lexis.com/document?crid=97eb19b4-0716-463c-bc3f-dac7ff9227b4&pddocfullpath=%2fshared%2fdocument%2flegalnews%2furn%3acontentItem%3a5JG5-BDP0-0063-32XD-00000-00&pdcontentcomponentid=6141&pdmfid=1000516&pdisurlapi=true)

15 R. Rubin, "Donald Trump on Not Paying Taxes: 'That Makes Me Smart'", *The Wall Street Journal* (26 September 2016), available at http://blogs.wsj.com/washwire/2016/09/26/donald-trump-on-not-paying-taxes-that-makes-me-smart/.

16 Id.

17 One might surmise that Trump would make large charitable gifts in order to redirect tax revenue to charitable donees so that the government will not squander the revenue, but there is little evidence of tax-planned charitable gifts from Trump. See H. Ordower, "Charitable Contributions of Services: Charitable Gift Planning for Non-Itemizers", 67 *Tax Lawyer* 517, 533 (2014) and section titled "Some examples of simple tax planning", Example 3: Charitable Deductions.

18 Ordower, Culture, see note 1 at 53.

19 C. Waerzeggers and C. Hillier, "Introducing a General Anti-Avoidance Rule (GAAR)", IMF Technical Note, IMF Legal Department (January 2016) (listing 12 countries but not including India, Ireland, and the United States, also having GAARs or their equivalent) available at www.imf.org/external/pubs/ft/tltn/2016/tltn1601.pdf. On general anti-avoidance rules (GAARs), see Part D of this book; Ordower, Culture, see note 1 at 94; R. Prebble and J. Prebble, "Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study", 55 *Saint Louis University Law Journal* 21 (2010).

been economically unsound without the tax benefits.[20] Capturing tax benefits becomes a primary investment objective rather than something incidental to another economic investment objective. Tax planners exploit three related types of tax structuring opportunities: (1) legislation offering tax incentives; (2) structural alternatives that generate differing tax outcomes without altering the non-tax economic consequences of the transaction; and (3) unintended statutory flaws and ambiguities, including legislatively sanctioned tax incentives exploited in ways not intended or not foreseen by the enabling legislation.[21] Both the existence of legislation delivering economic incentives through the tax system and opportunities to structure transactions producing substantially identical economic outcomes but differing tax outcomes create ambiguity concerning appropriate and inappropriate tax structuring. That ambiguity makes it difficult for tax administrators to combat what they perceive to be inappropriate tax planning and for courts to interpret ambiguous statutes as the legislatures may have intended them.

At all socioeconomic levels, and with respect to all taxes, attentiveness to opportunities to minimize taxes is common. Some techniques are legal, some questionable, others clearly illegal (whether or not enforced). Yet there is probably less uncertainty of applicable law for middle- and lower-income taxpayers than there is at the higher-income end. For example, the high audit rate for the earned income tax credit applicable to low-income, employed or self-employed taxpayers reflects substantial noncompliance by taxpayers and a relatively straightforward and unambiguous eligibility rule.[22] Similarly, failure to report income from services performed by middle- and lower-income taxpayers often is fraudulent – tax evasion rather than tax avoidance. A household worker or a laborer who receives payment in cash and does not report the income is evading, not avoiding, tax.[23] Barter exchange of services for services or services for property is unambiguously gross income to both parties to the exchange, although in many instances determining the correct amount to include in income may be difficult and securing voluntary reporting and compliance may be even more difficult.[24] In difficult valuation instances, generally toward the higher end of the income spectrum, the tax collector and the courts may choose not to confront the valuation issue, instead finding an exclusion from income[25] or fixing value at

20 During the 1970s and 1980s, promoters frequently sold tax sheltered investments to taxpayers in the U.S. that produced no independent economic return absent the associated tax benefits. Ordower, Culture, see note 1 at 55–8.

21 Categories (2) and (3) become the subject of the general and special anti-avoidance rules, see note 19 and accompanying text, and discussed below in text accompanying note 107.

22 In the tax years 2006–2008, only 1.6 percent of the returns claiming an earned income tax credit under IRC §32 were accepted as filed, 94.8 percent were subjected to an office or field audit. Internal Revenue Service, "Compliance Estimates for the Earned Income Tax Credit Claimed on 2006–2008 Returns" (2014), available at www.irs.gov/PUP/individuals/EITCComplianceStudyTY2006-2008.pdf.

23 In the case of some low income workers, failure to report their income from services is contrary to their best economic interests even if they never get caught underreporting income. Some forego the opportunity to claim the earned income tax credit under IRC §32 on their income from services. And underreporting and not reporting income from services may diminish or cause the individual not to qualify for social security benefits when the individual reaches the qualifying age. And, see, the discussion of the tax gap, in text accompanying and following note 137.

24 IRS, "Four Things to Know About Bartering", IRS Tax Tip 2012-33 (17 February 2012), available at www.irs.gov/uac/four-things-to-know-about-bartering-1). Consider a common babysitting exchange in many communities where parents log hours caring for other children in a pool of families and can draw hours having another parent care for his or her children. No money changes hands, just babysitting services. See also the discussion of the tax gap under heading "Tax gap and the tax avoidance culture" below.

25 *Benaglia v. Commissioner*, 36 B.T.A. 838 (1937) (holding meals and lodging provided for the convenience of the employer are excludable from gross income). Congress codified the result in the case in I.R.C. §119.

zero.[26] Likewise, conversion of income from services in the form of "carried interests" in partnerships from ordinary income to more favorably taxed capital gain is acceptable, nonfraudulent behavior.[27]

Some examples of simple tax planning

The following paragraphs present four simple and common examples of effective tax planning. Only the sales/use tax example benefiting a wide range of income groups represents impermissible planning that violates the law, although it generally remains unenforced. The others, benefiting relatively high-income taxpayers, are unquestionably legal. The "carried interest" example[28] has been the subject of legislative discussion on account of it being viewed by some commentators, including both US presidential candidates in 2016[29] and legislators as excessive and unjustified. Legislative elimination of the opportunity has been recommended but not enacted. There is nothing remarkable about the four opportunities. The legislature could make simple changes in the law to eliminate the opportunities, but it has not. The opportunities illustrate that elimination of tax avoidance requires action by the legislature but the legislature has no commitment to a consistent anti-avoidance plan. Legislative ambiguity tends to dominate as the public discussion in the legislature is critical of tax avoidance but the legislature continues to use the tax system to deliver subsidies, identifying them in budgeting as tax expenditures.[30]

Example 1: tax exempt bonds

Whenever the legislature delivers subsidies for an activity through the tax system, there is a risk that the subsidies will become misdirected. Capture of the tax-based subsidy in a manner relatively consistent with the legislative intent is unremarkable and difficult to criticize. And similarly, that observation remains valid even if the taxpayer who captures the subsidy is better off than he or she would have been if the legislature had chosen to deliver the subsidy directly. Economic inefficiency built into subsidies is not the fault of the taxpayer but represents an ambiguous and wasteful legislative choice. Tax exempt bonds for state and local governments exemplify such inefficient choices.[31]

The exemption from gross income of interest paid on bonds a state or local government issues enables the governmental debtor to pay a below-market rate of interest.[32] The difference between the interest the governmental unit would pay at a market rate and the amount it must

26 See note 50 and accompanying text. *Campbell v. Commissioner*, 59 TCM (CCH) 236 (1990), aff'd. in part, rvs'd. in part, 943 F2d 815 (8th Cir. 1991) (holding a profits interest to have indeterminate value and not includable in income). Rev. Proc. 93-27, 1993-2 C.B. 343 (treating the receipt of a profits interest for services as non-taxable when received, unless certain exceptions rendering valuation simple and straightforward apply). See the carried interest example below under heading "Some examples of simple tax planning", Example 2.

27 See *infra* note 40 and accompanying text which describes an opportunity arising from the failure to determine value.

28 Example 2, below, profits interest in a partnership.

29 See *infra* note 50.

30 US Department of the Treasury, "Resource Center: Tax Expenditures", available at www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx (defining the tax expenditure concept and estimating the amounts of tax expenditures each year).

31 I.R.C. §103 (exempting interest paid by a state or local government on its obligations from the gross income of its recipient/lender).

32 *South Carolina v. Baker*, 485 US 505 (1985), dispelled a common misconception that the Constitution prohibited the United States from taxing the interest state and local governments pay on their obligations.

pay at the tax exempt rate is intended as a subsidy to or revenue sharing with the state and local governments delivered through the federal income tax system. If the subsidy were efficient, the bondholder would receive the identical return on invested funds with comparable risk profiles[33] whether invested in the government obligation or a fully taxable obligation.

To illustrate: A taxpayer subject to a 40 percent marginal rate of tax[34] who invests $1,000 in taxable bonds paying 10 percent interest receives $100 of taxable interest income and has $60 remaining after tax. The tax exempt rate of interest for that taxpayer should be 6 percent if exempt bonds and taxable investments produced identical after-tax investment returns and the state or local bond issuer gets the 4 percent interest subsidy. Likewise, the rate for a 30 percent marginal-rate taxpayer should be 7 percent. State and local governments, however, may not set the interest rate on their obligations to the investors' differing tax characteristics or discriminate in rates paid among investors. These governments must choose an interest rate at which they can sell their bonds. Generally, there are insufficient buyers paying tax at the maximum marginal rate, so the governmental unit must set its rate higher to sell the bonds to below-maximum-marginal-rate taxpayers. If the rate is set for the 30 percent taxpayer (that is, 7 percent yielding $70), the 40 percent taxpayer receives a tax exempt bonus of $10 by buying the bond. The 40 percent investor gets a return approximately equal to an 11.67 percent taxable return. The state or local government receives a 3 percent subsidy, and the 40 percent taxpayer receives an additional 1.67 percent subsidy to her return on investment that the statute probably did not intend.[35]

It is possible that Congress concluded historically it had no power to tax the interest paid by state governmental units and that the statute simply codified that conclusion.[36] Congress could eliminate that inefficiency in delivery of the subsidy in a number of ways, including (a) providing a direct interest subsidy to state and local governments rather than the tax subsidy, or (b) substituting a tax credit for the exclusion.[37] But Congress does not do so[38] and the higher bracket taxpayer gets a tax subsidy greater than what the legislature intended – a form of tax avoidance inconsistent with but incidental to the intended subsidy.

Example 2: carried interests

One prominent example of successful tax planning that has received legislative attention, albeit without enactment of a legislative remedy, is the favorable taxation of private equity and hedge

33 In the case of publicly issued government and corporate bonds, Standard and Poor's, Moody's Investor Services and Fitch control the bulk of the bond rating business. Their ratings of the creditworthiness of the bond issuer enable the underwriters of the bonds to position the bonds for sale in the markets at a competitive interest rate so that a corporation with a AAA rating from Standard and Poor's should pay the same interest rate as a governmental unit with the same rating.

34 Tax rates are hypothetical to simplify the illustration, but in this instance the 40 percent rate is roughly the current 39.6 percent maximum rate imposed on the ordinary income of individuals under I.R.C. §1.

35 I.R.C. §103; and *see South Carolina v. Baker*, see note 32.

36 Compare I.R.C. §104(a)(2), excluding personal injury recoveries from gross income and originally codifying existing law. H. Ordower, "Schedularity in US Income Taxation and Its Effect on Tax Distribution", 108 *Northwestern University of Law Review* 905, 920 (2014).

37 Joint Committee on Taxation, "The Federal Revenue Effects of Tax-Exempt and Direct-Pay Tax Credit Bond Provisions", JXT-60-12 (2012), available at www.jct.gov/publications.html?func=startdown&id=4470.

38 Congress did rein in the ability of taxpayers to leverage their investments in tax exempt bonds by denying a deduction for interest paid to carry tax exempt investments under I.R.C. §265(a)(2), governmental units to leverage their exemption from tax under I.R.C. §115 with anti-arbitrage rules under I.R.C. §103(b)(2) (interest on arbitrage bonds not exempt) and to limit their ability to lend their borrowing power for private use with special rules applicable to private activity bonds under I.R.C. §§103(b)(3), 148 et seq.

fund managers on their "carried interests."[39] Private equity and hedge funds customarily operate as limited partnerships with the managers receiving 1 or 2 percent of the capital in the fund annually as a management fee and an additional amount of 10 to 20 percent of the increase in value of the fund as an interest in the profits of the partnership.[40] In most instances, the annual assets-based fee is ordinary income to the manager.[41] The performance allocation also would be characterized as a performance fee and generate ordinary income to the manager if it were paid in cash, but it is not. Instead the partnership determines the increase in the value of its assets periodically and allocates 10–20 percent of that amount to the manager's capital account. The amount allocated precedes the realization of gain by the partnership, and any final determination of the amount the manager will receive awaits the partnership's disposition of its assets even though the manager's interest in the partnership increases.[42]

As an interest in and a function of the profits of the partnership, that additional amount, referred to as a "carried interest" in the literature, often yields long term capital gain to the manager. Decisional law[43] and a procedural announcement from the Internal Revenue Service[44] treat profits interests received for services as having no value when received. The partnership's allocation to the manager of a distributive share of the partnership's taxable income and gain with respect to those profits interests under partnership rules preserves the character and source of income realized by the partnership as it is included in the partners' incomes.[45] In the case of a private equity fund particularly, that income will be capital gain when the fund ultimately sells its investment in the stock of a corporation in which it has invested. The manager's share of the gain therefore is also long term capital gain[46] rather than ordinary income from services. Distributions of cash with respect to those profits interests reduce the manager's adjusted basis in the

39 V. Fleischer, "Two and Twenty: Taxing Partnership Profits in Private Equity Funds", 83 *New York University Law Review* 1 (2008) (analyzing various arguments for taxing a profits interest but concluding that the private equity fund managers should have ordinary income from their profits interests in the private equity funds); H. Ordower, "Taxing Service Partners to Achieve Horizontal Equity", 46 *Tax Lawyer* 19 (1992) (arguing that the profits interests should be taxable as open transactions).

40 H. Ordower, "The Regulation of Private Equity, Hedge, and State Funds", 58 *American Journal of Comparative Law* 295, 304–5 (2010).

41 Private equity fund managers in some instances sought to convert the management fee into capital gain as well. For an explanation, see G. D. Polsky, "Private Equity Management Fee Conversions" (4 November 2008). FSU College of Law, Public Law Research Paper No. 337; FSU College of Law, Law, Business & Economics Paper No. 08-18, available at SSRN: http://ssrn.com/abstract=1295443 or http://dx.doi.org/10.2139/ssrn.1295443. In 2015, the IRS issued proposed regulations amending the I.R.C. §707 regulations to prevent conversions. IRS, Disguised Payments for Services, 2015-32 IRB (10 August 2015), available at www.irs.gov/irb/2015-32_IRB/ar09.html.

42 Customarily, the manager's interest in the partnership does not decrease if the partnership's assets lose value, but the manager often may not receive any further allocation under the profits interest until the partnership's value reaches the highest value with respect to which the manager received an allocation earlier. H. Ordower, "Demystifying Hedge Funds: A Design Primer", 7 *UC Davis Business Law Journal* 323, 359 (2007).

43 *Campbell v. Commissioner*, see note 26 (holding a profits interest to have indeterminate value and not includable in income).

44 Rev. Proc. 93–27, see note 26, 1993–2 C.B. 343 (treating the receipt of a profits interest for services as nontaxable when received, unless certain exceptions rendering valuation simple and straightforward apply, leaving the partner to receive a distributive share of the partnership's income).

45 IRC §702(b).

46 Long term capital gain becomes net capital gain to the extent it exceeds capital losses. I.R.C. §1222. For noncorporate taxpayers, net capital gain is taxed at significantly lower rates than ordinary income, currently a maximum rate of 20 percent rather than 39.6 percent for ordinary income. I.R.C. §1(h). Capital gain is also free from the social security tax and the Medicare tax but is now subject to the net investment income tax of 3.8 percent under I.R.C. §1411.

manager's interest in the partnership and yield gain from the sale or exchange of those interests if the distributions exceed the manager's basis.[47]

Proposals to alter the rules for private equity fund managers on carried interests suggest that some members of Congress view the favorable tax treatment as unjustified – a legislatively unsanctioned form of tax avoidance that benefits some very wealthy private equity fund managers. Yet the proposals to stop this seeming conversion of ordinary compensation income into long term capital gain have foundered.[48] There is apparently no legislative will to change tax rules favoring this small but wealthy taxpayer group of private fund managers. Very recently, some commentators have suggested that the president and the Department of the Treasury can change the tax outcome without the need for Congress to act,[49] and, as noted earlier, both presidential candidates expressed their intention to fix the carried interest problem.[50]

Example 3: charitable deductions for gifts of appreciated assets

Taxpayers in the United States who itemize their deductions[51] may deduct the amount of their charitable gifts[52] in determining their taxable income.[53] The charitable deduction diminishes the cost to the taxpayer of making the charitable gift by the amount of the gift multiplied by the taxpayer's maximum marginal rate of tax.[54] Accordingly, a taxpayer subject to the maximum rate of 39.6 percent bears only 60.4 cents of each charitable gift dollar because the federal treasury reimburses 39.6 cents through the deduction.[55] Taxpayers who do not itemize deductions secure no tax benefit from their contributions.[56]

In addition, the dollar amount of a charitable gift of property, other than money, is the fair market value of the property on the date of the gift.[57] If a donor who itemizes deductions gives appreciated property to charity, the donor not only gets a deduction equal to the fair market value of the donated property but also need not recognize and include in income the previously

47 I.R.C. §731.

48 See, "Ways and Means Committee Democrats, Carried Interest", available at http://democrats.waysandmeans.house.gov/issue/carried-interest.

49 D. J. Hemel, "The President's Power to Tax", 103 *Cornell Law Review* (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2773329 (arguing the President has the power to change the carried interest through regulatory action); G. Morgenson, "Ending Tax Break for Ultrawealthy May Not Take Act of Congress, Fair Game", *The New York Times* (6 May 2016), available at www.nytimes.com/2016/05/08/business/ending-tax-break-for-ultrawealthy-may-not-take-act-of-congress.html?_r=0.

50 W. Elmore, "Clinton Would Ask Treasury to End Carried Interest Preference", 2016 TNT 116-3 (15 June 2016). Presidential candidate Trump expressed his intention to eliminate the carried interest opportunity. However, Trump also planned to reduce the rate of tax on all business income to 15 percent so that the rate of tax would be lower than currently imposed even on net capital gains.

51 I.R.C. §63(d) (allowing certain deductions, including the deduction for charitable gifts under I.R.C. §170, for noncorporate taxpayers to the extent the deductions aggregate more than the standard deduction amount).

52 I.R.C. §170 (charitable contribution deduction).

53 I.R.C. §63(a) (taxable income defined).

54 Or, if the deduction would cause the taxpayer's maximum rate to decline, all or part of the deduction will yield a deduction at the lower rate.

55 Ordower, "Charitable Contributions of Services", see note 18, at 519–21.

56 Charitable contribution deductions raise difficult policy issues since they enable donors to redirect government revenue through the deduction to charitable organizations, including religious institutions and churches, despite the separation of church and state under the First Amendment to the US Constitution.

57 Treas. Reg. §1.170A-1(c), 26 CFR §1.170A-1(c) (deduction for contribution of property is the fair market value of the property).

unrealized gain in the value of the donated property.[58] For example,[59] assume the 40 percent bracket taxpayer gives corporate stock to charity that has a value of $100 and an adjusted basis of $1. The taxpayer gets the deduction subsidy of $40, as in the preceding paragraph, plus an additional subsidy of the avoided $20 tax on the long-term capital gain that the taxpayer would have incurred upon the sale of the property.[60] Thus, the cost of the donation to the donor is only $40 for each $100 gift. If the donor also receives an intangible and nontaxable benefit from the charity – naming rights to a building, for example – the value to the donor of the charitable gift and deduction may even be greater.[61]

Consistent with the apparent legislative intent to encourage charitable giving, charitable donors contributing appreciated property receive a direct contribution subsidy through the charitable deduction and avoid the tax on appreciation in the value of property other than money they contribute. The value to a donor from the government subsidy of the charitable gift increases as the donor's marginal rate of tax increases so that the maximum charitable deduction benefit is available to the highest income taxpayers. Compare the Canadian model for charitable contributions that gives a substantially equal tax credit to all charitable donors without regard to their marginal tax rates. Canada pegs the credit to the maximum marginal rate of income tax.[62]

Congress has limited the deduction for appreciated property to the taxpayer's adjusted basis in two instances. In the case of property that would generate ordinary income when sold – inventory and depreciation recapture property, for example – the taxpayer's deduction, with exceptions, is limited to her adjusted basis in the donated property.[63] Similarly, in the case of property which would generate capital gain,[64] if the charitable recipient's use of donated tangible personal property is not related in service or use to its charitable purpose, the deduction also is limited to the taxpayer's adjusted basis in the donated property.[65] However, Congress has not sought to deny the benefit or require the donor to recognize gain on the donated property for even highly appreciated intangible property.

Example 4: sales and use tax – avoidance or evasion?

While the permissible tax planning opportunities described in the previous three examples are practical exclusively for some high- or moderately high-income taxpayers and are not available

58 I.R.C. §1001 (codifying the realization requirement and determining the amount of gain or loss realized on the sale or other disposition of property and including the gain or loss in income). For a discussion of the distributional effects of the realization requirement, see Ordower, "Schedularity", see note 36, at 910–12.

59 Amounts will be rounded for purposes of the illustration.

60 I.R.C. §1(h) (setting the maximum marginal rate for net capital gain, with limited exceptions, at 20 percent). In the case of a taxpayer selling a closely held corporation who has a religious obligation to tithe, the taxpayer must give the shares to the church first so that the taxpayer has made a gift of the property before sale yield a charitable contribution deduction equal to the value of the shares on the date of the gift. The church must agree independently to sell the shares to the buyer in order for the taxpayer to capture the full charitable deduction/exclusion benefit. If the taxpayer gives the proceeds of the sale to the church, the taxpayer rather than the church will be taxable on the gain and the taxpayer would not capture the benefit of the gain exclusion from a charitable gift.

61 W. Drennan, "Where Generosity and Pride Abide: Charitable Naming Rights", 80 *University of Cincinnati Law Review* 58, 66 (2012) (charitable naming rights have a zero value under current rulings).

62 Sec. 118.1(1) of the Income Tax Act (R.S.C. 1985, c. 1 (5th Supp.), available at http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-113.html#docCont. For an explanation, see Canada Revenue Agency's "Charities and giving" webpage, www.cra-arc.gc.ca/chrts-gvng/menu-eng.html.

63 I.R.C. §170(e)(1)(A), exceptions for certain inventory categories apply under I.R.C. §170(e)(3).

64 Includes I.R.C. §1231 gain.

65 I.R.C. §170(e)(1)(B).

to the bulk of taxpayers, moderate- and low-income taxpayers have been offered limited opportunities to avoid or evade some of their taxes. Without regard to their income or wealth, consumers who have computer and credit card access often favor purchasing goods over the internet from out of state vendors in order to avoid having to pay sales tax or the complementary use tax on their purchases.[66] Unless the state may impose the obligation to collect the state's use tax on the vendor shipping into the state, collection of the use tax is impractical because the state must rely on voluntary reporting and payment by the consumer.[67] If a vendor has no physical presence in the shopper's state of residence, the vendor need not collect the state sales or use tax at point of sale on shipments into the shopper's state, as US Supreme Court decisions prohibit states from imposing an obligation to collect use taxes on vendors that do not have a physical presence in the state.[68] The rapid growth of sales by internet retailers is attributable in part to the sales and use tax void that the physical presence test creates.

Some states have sought to collect the use tax through an attachment form to their state income tax return, but those efforts have met resistance and limited success with collection.[69] A growing number of states have enacted "Amazon laws" to close the void.[70] Those laws require many out of state vendors using in-state servicers or other types of affiliated businesses to solicit sales to collect the state's use tax on sales for shipment into the state.[71] The Supreme Court denied certiorari in a challenge to the "Amazon laws," thus allowing a state decision upholding the collection and reporting obligation to stand.[72] And, in the Supreme Court's most recent decision affirming the physical presence test, it stated in *dictum* that Congress has the power to modify the physical presence limitation.[73]

Unlike the previous three examples of tax avoidance, the consumer's failure to pay the use tax is more than tax avoidance. No legislation, administrative action or judicial decision sanctions the consumer's failure to report and pay the use tax. Judicial decisions only relieve vendors of the obligation to collect the tax at point of sale and pay it over to the state. Each state imposes a statutory obligation, often with an exemption amount, on all consumers to report and pay tax

66 Sales tax is an add-on tax a vendor is required to collect on in-state sales when it sells goods (and sometimes services) to a consumer. States that impose a sales tax also impose a complementary use tax at the same rate on consumers who purchase items outside the state but bring the items into the state for use in the state (includes items shipped into the state). Consumers who paid a sales tax in the state of purchase receive a credit for the tax paid at point of sale but not more than the amount of use tax payable in the state of use.

67 Except for items like automobiles which the buyer must register, so that the state may collect the tax at registration.

68 *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (reaffirming the physical presence test requirement of the Commerce Clause and refusing to impose the obligation on an out of state vendor to collect the state's use tax on sales to residents of the state).

69 N. Manzi, *Use Tax Collection on Income Tax Returns in Other States*, Minnesota House of Representatives (2015), available at www.house.leg.state.mn.us/hrd/pubs/usetax.pdf.

70 The nickname "Amazon laws" is a reference to the online retailer Amazon.com.

71 New York and other states have enacted legislation imposing an obligation to collect use taxes on retail vendors that use a local affiliate to solicit sales in the state. N.Y. Tax Law §1101(b)(8)(i)(C)(I) (McKinney, 2013). The Supreme Court denied certiorari in a challenge to the New York law in *Overstock.com, Inc. v. New York State Dept. of Taxation & Fin.*, 134 S. Ct. 682 (2013). See generally E. K. Lunder and C. A. Pettit, "'Amazon Laws' and Taxation of Internet Sales: Constitutional Analysis", CRS Report (9 April 2015), available at www.fas.org/sgp/crs/misc/R42629.pdf (discussing click-through nexus for use tax).

72 *Overstock.com, Inc. v. N.Y. State Dep't of Taxation & Fin.*, 20 N.Y.3d 586, 987 N.E.2d 621, 965 N.Y.S.2d 61 (2013), *cert. denied,* 134 S. Ct. 682, 187 L. Ed. 2d 549 (2013) (upholding click-through nexus under NY CLS Tax §1101(b)(8)(vi)).

73 *Quill Corp. v. North Dakota*, see note 68, at 318. Note that 11 states joined in an amicus brief to the Supreme Court (release date 7 November 2016) urging the Court to grant certiorari in *Brohl v. The Direct Marketing Association* (16–458) to overrule *Quill*. 2016 STT 217-9 (9 November 2016).

on out of state purchases of goods that they use in the state.[74] Failure to report and pay is tax evasion, an illegal act, not lawful tax avoidance. Thus, the invitation to avoid taxes that the other opportunities offer is evasion in the case of consumers' failure to pay use tax.[75] This distinction between the use tax example and the private equity fund example is stark as it favors high-income individuals and protects their tax avoidance while lurking with possible penalties for the moderate- and low-income individuals.[76] While both opportunities originated in decisional law, the one affecting high-income and high-wealth taxpayers involves no illegality when the taxpayers exploit it. The one affecting all types of taxpayers involves tax evasion when the taxpayers at all income levels exploit it.

Yet ambiguity regarding consumers' obligation to pay the use tax persists. Many consumers may be unaware of their use tax obligation when out of state vendors do not collect the tax at point of sale.[77] Frequently, vendors openly have advertised that they did not collect the tax on their out of state sales.[78] And even the use tax statutes leave ambiguity regarding consumers' compliance obligations. The statutes may impose no criminal penalties on the consumer, and civil penalties are rarely imposed.[79] This ambiguity on compliance obligations in the absence of criminal penalties, along with the lack of effective enforcement at consumer level, contributes to wide-scale noncompliance.[80]

Tax benefit asymmetry: ambiguity in legislative purpose

The tax outcomes in the examples in the previous sections lack symmetry and rationality. In the tax exempt bond example, Congress chose to reduce the borrowing cost for state and local governments by making interest on their obligations free from federal income tax. In facilitating that interest rate subsidy, however, Congress selected an inefficient and wasteful tax structure. The subsidy transfers substantial value to high marginal tax bracket taxpayers who receive tax exempt interest in excess of any competitive market rate of interest. The inefficiency in delivery of the subsidy is manifest.

Yet Congress has not acted to make the subsidy more efficient or symmetrical across taxpayer groups. Congress could eliminate the asymmetry but does not. Perhaps Congress's inaction is attributable to the longevity of the exemption for state and local bond interest. No constituency in Congress is interested in revisiting the structure of the deeply rooted expectations the statute

74 For example, NY CLS Tax §1110 (imposing a compensating use tax equal to the sales tax).

75 Id., stating the obligation to pay use tax and offering a simplified computation of use tax based on income.

76 This is not to say that high-income individuals do not evade sales and use taxes. See, e.g., G. Bowley, "Lawsuit Accuses (Alec) Baldwin of Dodging Sales Tax", *The New York Times* C2 (28 October 2016). Use of the term "dodging" suggests tax avoidance, not evasion or acceptable evasion.

77 M. Cohn, "More States Expect Taxpayers to Report Their Use Tax", *Accounting Today* (13 April 2012), www.accountingtoday.com/blogs/debits-credits/States-Use-Tax-CCH-62331-1.html.

78 Recently vendors have retreated from such advertising and substituted complex description of the consumer's tax obligation with a link at the bottom of the webpage. See, e.g., www.tigerdirect.com/sectors/help/taxinfo.asp.

79 For example, NY CLS Tax §1817 (imposing criminal penalties but not on consumers for failure to report and pay). As to civil penalties, see, for example, the New York State approach in "Use Tax for Individuals (including Estates and Trusts)", *Tax Bulletin ST-913 (TB-ST-913)* (19 February 2016), available at www.tax.ny.gov/pubs_and_bulls/tg_bulletins/st/use_tax_for_individuals.htm.

80 Noncompliance on use tax is not indicative of noncompliance on other taxes, although wage earners are subject to withholding on income and social security taxes, interest and dividend income – the subject of third-party reporting – making the income tax and the social security tax more difficult to evade. See the discussion of the tax gap, below under heading "Tax gap and the tax avoidance culture".

offers, even though Congress has modified the statute on several occasions to limit the subsidy[81] and easily could tax the state and local bond interest and share revenue with the states to provide the subsidy the exemption currently intends.

Similarly, the charitable contribution deduction that favors high marginal bracket, itemizing taxpayers, especially those who own highly appreciated, intangible investment property, is long-standing and entrenched in the tax law. While Congress has acted to limit the deduction to tax basis in the case of certain types of property,[82] it has done nothing permanent to distribute the tax benefit symmetrically among taxpayer groups. The excess subsidy for charitable contribution could be eliminated by requiring taxpayers to include appreciation in income when they make a charitable gift of appreciated property or by limiting the deduction to the taxpayer's adjusted basis in the property – if a charitable deduction is worth preserving at all in the tax law.

In the private equity fund example, very high-income taxpayers convert income from services from the ordinary income classification generally applicable to income from services into long-term capital gain. This asymmetry in taxing some income from services as long-term capital gain and most income from services as ordinary income[83] encourages more sophisticated tax planning than the other examples. Structure is critical to defining the partnership interest as a profits interest in compliance with the administrative ruling.[84] While judicial and administrative decisions may have created the asymmetry, a legislative fix would be simple. Minimal amelioration of the asymmetry resulted from tax law changes under the Affordable Care Act[85] that removed the accompanying Medicare tax advantage from converting service income to investment income.[86] Investment income, including long-term capital gain received through a partnership, when the taxpayer's modified adjusted gross income exceeds $250,000, now is subject to a 3.8 percent Medicare tax.[87]

In the bond interest and charitable contribution examples, tax planning for the higher-bracket taxpayer seems unassailable. The taxpayer invested in the bond without any unusual investment structuring and received the unintended, but unavoidable, excess benefit. The investor is avoiding taxes on interest income by a straightforward selection of a tax exempt, rather than a taxable, bond. Both tax exempt and taxable bonds probably were available and open to all investors, and the investor was free to choose between them and among other available investments. The tax benefit simply was incidental to that investment choice for high marginal rate taxpayers. In the charitable contribution example, the high bracket taxpayer used generally available charitable contribution rules. Nothing questionable occurred. Additional tax planning might enable the taxpayer to gain additional advantages in the charitable context, but the basic charitable contribution fair market value deduction is uncomplicated. In both the bond interest and charitable contribution examples, one might disagree with the statutory design as it is wasteful of tax revenue, but the opportunity is generally available and discriminates only incidentally among taxpayers based upon their individual tax rate brackets. That type of discrimination in favor of high marginal bracket taxpayers is characteristic of any exclusion from income

81 Arbitrage rules and private activity bond rules. I.R.C. §103(b).

82 I.R.C. §170(e).

83 Under I.R.C. §1(h), net capital gain of individuals is taxed at a maximum rate roughly half the maximum rate for income from services – 20 percent rather than 39.6 percent.

84 Rev. Proc. 93–27, see note 44, 1993-2 C.B. 343.

85 Patient Protection and Affordable Care Act of 2010, 123 Stat. 119 (2010).

86 I.R.C. §1401(b) imposing a 2.9 percent hospital insurance tax on self-employment income; I.R.C. §3101(b) (similarly on wages) but not on investment income.

87 I.R.C. §1411 (tax on net investment income).

or deduction in yielding a greater amount of tax savings as the taxpayer's marginal income tax bracket increases. Similarly, the realization requirement that allows unrealized gain to remain untaxed until the taxpayer sells the appreciated property provides greater benefit from deferral to higher-bracket taxpayers.[88]

In the private equity, partnership profits interest example, judicial and administrative interpretation of tax law has yielded a valuable tax planning opportunity. Unlike the bond interest and charitable contribution examples, something does seem wrong in the conversion of ordinary service income into long-term capital gain. Both the Republican and Democratic 2016 U.S. presidential candidates agreed that there is something wrong with the conversion and said they planned to eliminate the opportunity when elected.[89] Yet Congress has not acted to eliminate the tax planning opportunity in partnership profits interests despite an array of possible solutions, including open transaction reporting for the receipt of partnership profits interests[90] and taxing part of the partnership's allocation and distribution to the manager as ordinary income.[91]

The three planning examples for high-bracket taxpayers highlight the lack of legislative resolve to eliminate tax planning opportunities that misdirect government revenue to private use by allowing some taxpayers to avoid all or a portion of their tax responsibility. In the examples, it is difficult to imagine a compelling policy reason for asymmetry in tax treatment of different taxpayers that results in inefficient delivery of intended tax subsidies. Even if there may have been a reason for offering an excess benefit originally or the opportunities to misdirect a benefit were not obvious to the legislature when it enacted the statute providing the benefit, permitting continuing asymmetry and inefficiency runs contrary to the presumptive legislative purpose to distribute tax burdens fairly and symmetrically. Instead only legislative intention to offer tax benefits to high income taxpayers is visible. In addition, when straightforward statutory adjustments might eliminate any misdirection of the benefit and unanticipated revenue loss, the continuing failure of the legislature to act encourages tax planners for the wealthy to seek other, perhaps less obvious and less permissible techniques to exploit flaws in the tax rules – understanding that the legislature will do little to prevent the exploitation and the courts, observing no legislative resolve to eliminate the flaws, are unlikely to interpret the tax laws to prevent tax avoidance.[92]

Perhaps reflecting the legislature's ambiguity most clearly has been its reluctance to fund the operations of the tax collector. Despite statistics that show that for each sum spent on the IRS, the additional tax collection is many times the amount spent,[93] Congress resists increasing the IRS's budget and frequently cuts the IRS's budget.[94] The legislative message remains murky. The legislature may want to correct many of the flaws in the tax law, but the legislature does not provide the government's administrative agency the resources necessary to collect even the flawed tax.

88 I.R.C. §1001 (measuring realized gain and loss and including it in gross income).

89 See note 50.

90 Ordower, "Taxing Service Partners", see note 40, at 36–7.

91 D. Weisbach, "The Carried Interest Problem", 124 *Harvard Law Review* 1773, 1774–5 (2011) (discussing a proposed 75/25 split of ordinary income and capital gain under a new section 710 of the Code).

92 For discussion of the courts' role, see Ordower, Culture note 1, at 86–7.

93 IRS, "National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on Tax Reform", IRS Funding and Identity Theft, IR-2013-3 (9 January 2013), available at www.irs.gov/uac/newsroom/national-taxpayer-advocate-delivers-2012-annual-report-to-congress.

94 P. Bonner, "'Demanding Tax Season Likely Ahead', IRS Commissioner Tells AICPA", *Journal of Accountancy* (3 November 2015), available at www.journalofaccountancy.com/news/2015/nov/irs-commissioner-demanding-tax-season-ahead-2015.

And in the last example, an opportunity is available to all taxpayers, not just high-income taxpayers, and moderate- and low-income taxpayers seize the opportunity to escape paying a tax. Why should sales and use tax collection depend upon the physical presence of the vendor in the state in which the property purchased will be used? Judicial decisions under the Commerce Clause[95] ordaining such dependence may interpret the Constitution correctly, but those interpretations produce asymmetrical tax rules. Certain retail vendors may enjoy an advantage over others because they may offer a substantially tax-free price to the consumer by encouraging the consumer, albeit implicitly,[96] not to report. But the last example differs from the others because, in the avoidance of the state sales and use tax, consumers are evading, not just avoiding, the use tax they are obligated to pay. Consumers evade payment because the states lack any effective collection mechanism. At the same time, Congress has yet to act on the Supreme Court's invitation to eliminate the tax collection void.[97]

Like Congress, state legislatures have not provided the tools to prevent use tax evasion. The legislatures have not encouraged state revenue authorities to use their audit function aggressively to collect use tax from the consumer and have not enacted substantial civil and criminal penalties and funded enforcement to compel consumer reporting and payment of use tax. Increasing numbers of states have enacted "Amazon laws" to collect use taxes on out of state sales at point of sale. Despite widespread evasion by consumers of use taxes, no one has labeled individuals evading the use tax as scofflaws or morally corrupt, and there have been no use tax evasion prosecutions of consumers. The evasion behavior seems accepted and acceptable to the community at large. It is simply part of the culture of tax avoidance.

Tax avoidance: selecting among alternate structures

Tax planning that does not involve tax evasion is primarily the selection among possible structures for a transaction of the structure that yields more-favorable tax outcomes for one or more parties to the transaction than might have resulted without tax planning. Each of the four examples in the previous sections involves tax planning, although the last example relating to sales and use tax does involve tax evasion rather than avoidance. The bond investor chooses the tax exempt bond among investments because of the interest exclusion. The charitable donor may choose to make a charitable gift because the gift is deductible and may decide to give appreciated property, rather than selling the property and donating the proceeds, because the unrealized gain in the property will not be taxed to him. The private equity fund manager opts for an interest in profits rather than an immediate and taxable cash fee that he may invest in the partnership or elsewhere as he chooses. The consumer orders goods from out of state rather than going to a local vendor.

Sometimes the planning leads to more questionable manipulation and possibly evasion. The bond investor may borrow funds to invest in tax exempt bonds but not disclose the connection between the borrowing and the investment, thereby deducting the interest paid but excluding the interest income.[98] The charitable donor may overvalue the contribution, claiming a larger deduction than the law permits.[99] The private equity fund manager may monetize the profits

95 US Const. art. I, § 8, cl. 3.

96 Some advertise on their websites that they do not collect tax. And see note 78 supra and accompanying text.

97 See note 73.

98 I.R.C. §265(a)(2) (disallowing a deduction of interest incurred to carry tax exempt bonds).

99 I.R.C. §170(f)(8), (11) (substantiation requirements, generally, and appraisal requirements for property donations).

interest by borrowing against it without recourse so that he is not fully at risk in the partnership.[100] And the consumer, by not reporting the purchase in the state of residence and use, is evading the use tax. In each transaction, the non-tax economic outcome would be the same absent the tax planning. The bond investor would get a market rate return on investment. The charitable donor would give money to the charity (perhaps only the amount net of taxes payable on the gain). The private equity fund manager would receive 20 percent of the increase in the fund's value. The consumer would acquire the goods. The tax planning enhanced the economic value in each instance by transferring potential or actual tax revenues, hence tax expenditure, to private parties. Thus, tax planning augments the taxpayer's economic return from the investment by the amount of the tax the taxpayer avoids or by the reinvestment value of the deferred tax liability.[101]

Often the tax planned investment includes nonobvious or indirect structural variations that add value to the investment only by capturing a tax advantage that otherwise would not accompany the most logical and direct structure. Early in the development of the income tax, the US Supreme Court determined that the substance of a transaction, rather than its form, should control the transaction's tax characterization.[102] The holdings in early "substance over form" cases[103] suggest that tax planning should be of no avail. The substance of the transaction rather than its structure will control the tax outcome no matter how many possible structural permutations there may be that would reach the same economic outcome. And the "step transaction" corollary to the doctrine disregards unnecessary transactional steps that would alter the tax treatment but not the economic substance.[104]

Helvering v. Gregory[105] involved an example of an indirect structure designed to permit its sole shareholder to characterize what would be an ordinary income dividend as more favorably taxed capital gain. The unnecessary steps in the transaction were transparent, but together they fit within the tax characterization for which the taxpayer opted. The courts had some difficulty rejecting the taxpayer's characterization of her gain, and the novelty of the question allowed it to find its way to the Supreme Court. In *Gregory*, the Court applied the "substance over form" doctrine and held that a transaction structured as a tax deferred, divisive reorganization was a dividend in substance. The Court disregarded the reorganization form and taxed the shareholders on the receipt of a dividend according to the transaction's substance. Later Congress amended the

100 Rev. Proc. 93-27, see note 26, 1993-2 CB 343 (requires that the service partner not dispose of the interest within two years).

101 Many US tax shelters from the latter half of the twentieth century deferred but did not eliminate tax. The investing taxpayer reduced his or her tax liability in early years of the investment but absent rate changes would be liable for increased taxes when the tax benefits ended or for the amount of the deferred tax upon disposition of the investment. See discussion of deferral shelters in Ordower, Culture, s note 1, at 58 et seq.

102 *Weiss v. Stearn*, 265 U.S. 242 (1924); J. B. Donaldson, "When Substance-Over-Form Argument Is Available to the Taxpayer", 48 *Marquette Law Review* 41 (1964).

103 *Higgins v. Smith*, 308 US 473 (1940) (holding that a sale by a shareholder to his controlled corporation lacked economic substance to support a recognition of loss); later, *Knetsch v. United States*, 364 U.S. 361 (1960) (holding interest paid to carry a tax-deferred annuity product is not deductible where the otherwise tax deductible interest paid exceeds the nontaxable inside buildup in value, an economically unsound investment in the absence of the deduction for interest paid).

104 R. D. Hobbet, "The Step Transaction Doctrine and Its Effect on Corporate Transactions", 19 *Proceedings of the Annual Tulane Tax Institute* 102 (1970).

105 See note 2.

applicable statute to eliminate the opportunity to mischaracterize a transaction in that manner by including an active business requirement in corporate separations.[106]

As a precursor to the modern GAARs,[107] the "substance over form" doctrine has not worked well to limit opportunities for tax structuring designed to circumvent less favorable tax characterization of transactions. The doctrine's limitations do not bode well for the future success of GAARs. Tax avoidance structures manifest themselves in a wide variety of contexts. The preceding discussion of substance over form identifies one type of tax avoidance in transactions that take forms contrary to their economic substance. Use of fundamental structures like offshore corporations to avoid the incidence of worldwide taxation under US tax rules;[108] intentional flaws in tax rules like the structure of charitable contribution deductions[109] and tax exempt bonds;[110] special rules for specific activities, including real estate development,[111] low income housing,[112] oil and gas extraction,[113] purchase of durable goods;[114] and many other tax expenditures provide opportunities to plan transactions to exploit legislatively sanctioned tax benefits.

The United States has long used its tax system to deliver subsidies for investments the legislature deems beneficial. Accelerated depreciation,[115] for example, encourages taxpayers to invest in durable goods by permitting taxpayers to recover the cost of those goods for tax purposes by way of a deduction sooner than the goods economically waste as they produce income in the taxpayer's trade or business. The timing mismatch of economic waste and tax recovery gives the owner of the durable goods use of the depreciation tax savings for the additional time between tax recovery and economic waste – a temporary use of government funds without an interest charge. Encouraging purchase of durable goods is intended to stimulate the market for production and sale of durable goods as well as provide employment for those who produce the durable goods and, presumably, also for those using the durable goods. Tax planning consistent with the legislative subsidization of an activity through the tax system is unexceptional, so that a form over substance or step transaction analysis or a GAAR should not prevent the taxpayer from using an intended benefit in the way the legislature intended it to be used and even in ways incidental to the legislative intent like the tax exempt bond example previously given.

Against the backdrop of the broad array of subsidies delivered through the tax system, why would tax planners not seek to get a piece of those subsidies and stretch the rules as much as is possible to do so? The existence of the subsidies indeed stimulates the tax planning industry. The tax function that used to play a supporting role in the business world developed into a profit center as minimization of taxes became an independent goal for managers. As competition

106 The current statute prevents the spin-off of a corporation holding only liquid assets. I.R.C. §355(b) (requiring both the distributing and the distributed corporation to be engaged actively in the conduct of a business).

107 See note 19, general anti-avoidance rules.

108 The United States taxes its domestic corporations, citizens and residents on their worldwide income. Treas. Reg. §1.1-1(b). If, however, the US owner operates a business through a foreign corporation, the foreign corporation's income is not taxable in the United States until the corporation distributes its income to its US shareholder. Special anti-avoidance rules apply, including the controlled foreign corporation provisions, I.R.C. §951 et seq., to impose tax on the US owners of the foreign corporation under certain circumstances.

109 I.R.C. §170, discussed above in Example 3.

110 I.R.C. §103, discussed above in Example 1.

111 I.R.C. §168 (depreciable lives shorter than economic lives); I.R.C. §465 (exemption from at risk rules for borrowed funds).

112 I.R.C. §42 (low-income housing credits).

113 I.R.C. §263(c) (exception to capitalization for intangible drilling costs).

114 I.R.C. §179 (election to expense purchase and placement in service of tangible personal property).

115 I.R.C. §§168, 179.

within the tax planning industry grew and continues to grow, enormous amounts of creative effort have been and continue to be devoted to constructing transactions to capture tax benefits, whether intended for the specific transaction or not, probably with a loss of potential creative resources in actual production.[116] Distinguishing the intended use of a tax subsidy from the misuse of that subsidy, however, often proves elusive, as its use is buried in complex transactional structures. Even when tax avoidance can be identified in a transactional structure, concluding that the chosen structure is inconsistent with the delivery of the subsidy through the tax system may not be easy.

The delivery of subsidies through the tax system creates ambiguity as to legislative purpose. Some tax subsidies, used as intended, render transactions profitable that otherwise might not be because without the subsidy the activity is risky and uncertain so that necessary investors may be unavailable without the subsidy. Even the relatively new statutory economic substance requirement[117] must yield in situations in which the subsidy is intended to guarantee profitability and willing investors for the activity. Courts may be reluctant to disallow tax benefits where there is ambiguity as to the legislative intention except in instances in which the abuse of the tax benefits is most blatant and outrageous.

The preceding paragraphs do not argue that efforts to use general tax principles like economic substance and GAARs are futile. Rather the discussion is intended to highlight the limitations of those tools in staunching tax avoidance in all its forms. There are instances in which the tax planners overreach in structuring tax avoidance transactions and general tax avoidance principles and rules are effective. Taxing agencies certainly have enjoyed some limited successes in deploying general anti-avoidance tools. The courts continue to apply economic substance principles and GAARs in recent years to prevent tax avoidance through artificially constructed loss generating transactions involving financial products. For example, in June 2016, the Irish Supreme Court released its opinion disallowing a taxpayer's net tax loss from foreign currency straddles and gilts that the taxpayer used to offset much of the taxpayer's gain from real property sales. The taxpayer's economic loss from the structured transactions was less than 5 percent of that artificially generated loss.[118] Similarly artificial loss generating transactions using currency options and other complex financial products were disallowed in the "son-of-boss" initiative.[119] Taxpayers in some of those cases incurred substantial penalties.[120]

116 K.-D. Drüen, "Unternehmerfreiheit und Steuerumgehung [Entrepreneurial Freedom and Tax Avoidance]", 2008 *Steuer und Wirtschaft [STUW]* 154, 158 ("Steuerumgehung volkswirtschaftlich betrachtet den Wettbewerb und führt zur ineffizienten Allokation von Ressourcen, weil beträchtliches Personal in Unternehmen, Steuerberatung und Staat fern von wirtschaftlicher Nutzenmaximierung gebunden wird.") ["From an economic perspective, tax avoidance disrupts competition and leads to inefficient allocation of resources as considerable personnel in business, tax planning industries, and the state remain far from economic production maximization activity" (author's translation).] Footnote quoted from Ordower, Culture, see note 1, 48.

117 I.R.C. §7701(o) (economic substance requirement as a condition to claiming tax benefits).

118 *McNamee v. The Revenue Commissioners* [2016] IESC 33, available at www.supremecourt.ie/Judgments.nsf/1b0757edc371032e802572ea0061450e/bf972756bfa84ce880257fdb0053ec31?OpenDocument (dismissing the appeal challenging the application of the Irish GAAR, s. 811 of the Revenue Act of 1997).

119 I.R.S. Announcement 2004-46, 2004-21 I.R.B. 964 (offering a settlement initiative for taxpayers who engaged in certain sophisticated, capital loss generating structures that allowed them to deduct their expenses as long-term capital losses).

120 *United States v. Woods*, 571 U.S., 134 S. Ct. 557, 187 L. Ed. 2d 472 (2013) (upholding penalties for overstating basis in sham partnerships).

Tax gap and the tax avoidance culture

When Judge Hand made clear that "there is not even a patriotic duty to increase one's taxes,"[121] he provided a rhetorical boost for the tax avoidance culture. But Hand surely would have agreed that there is a patriotic duty to pay the taxes one owes. Commitment to that duty seems to be on the wane. There is constant anti-tax noise, and many seem to view state and federal tax administrative agencies as enemies. Federal legislators lay blame for the tax laws they enacted on the tax administrative agency by referring to them as the "IRS Code."[122] The Commissioner of Internal Revenue has been demonized and threatened with impeachment.[123] Politicians pledge that they will not increase taxes.[124] In some states, voters through initiative ballots have amended state constitutions to limit the state's ability to increase revenue to meet state expenses,[125] motivating state and local tax agencies to increase collection efforts and local governmental units to rely on tax substitutes such as revenue-based policing.[126]

With declining recognition of an obligation to pay taxes, a discredited and disdained tax collector, and an intricate, complex and often inconsistent body of tax law and interpretation, taxpayers at all income levels lose sight of the national and local importance of the taxing function. Instead they glean from the enormous amounts of professional resources devoted to tax compliance[127] and avoidance[128] that to avoid paying taxes is the principal goal of those who can afford the professional assistance. Taxpayers see legislatures that are unwilling to fund tax enforcement; they experience the enforcement efforts that do emerge targeting disproportionally the economically weak, low-income income taxpayers;[129] they learn that some at the very top of the political ladder, major parties' presidential candidates, engage in aggressive and controversial tax reduction planning; and they hear a continual barrage of anti-tax rhetoric.[130] Conflation of tax evasion and tax avoidance leaves a conceptual muddle. It seems little wonder that the culture of tax avoidance becomes ever more firmly embedded in the United States.

Moderate- and lower-income taxpayers, without tax law training and without the services of tax professionals, are unable (or unwilling) to distinguish legal tax avoidance from illegal tax

121 *Helvering v. Gregory*, see note 2.

122 M. Y. H. Lee, "Who Wrote the 'IRS Code'? Hint: It Wasn't the Internal Revenue Service", *Washington Post* (13 April 2015), available at www.washingtonpost.com/news/fact-checker/wp/2015/04/13/who-wrote-the-irs-code-hint-it-wasnt-the-internal-revenue-service/.

123 M. DeBonis, "Impeachment Vote Averted by Promise of IRS Commissioner's Testimony", *Washington Post* (15 September 2016), available at www.washingtonpost.com/news/powerpost/wp/2016/09/15/impeachment-vote-averted-by-promise-of-irs-commissioners-testimony/.

124 Some commentators believe that George H.W. Bush's violation of his pledge "Read my lips, no new taxes" cost him the presidency in 1992. See Top 10 Unfortunate Political One-Liners, *Time*, available at http://content.time.com/time/specials/packages/article/0,28804,1859513_1859526_1859516,00.html.

125 The 1980 Hancock Amendment in Missouri, Mo. Const. art. X, §§ 16–23, for example.

126 H. Ordower, K. Warren and O. Sandoval, "Out of Ferguson: Misdemeanors, Municipal Courts, Tax Distribution and Constitutional Limitations", 61 Howard L.J. (forthcoming), Saint Louis University School of Legal Studies Research Paper No. 2016–14, available at SSRN: https://ssrn.com/abstract=2854372.

127 GAO, "Tax Policy Summary of Estimates of the Costs of the Federal Tax System" (2005), available at www.gao.gov/new.items/d05878.pdf.

128 Drüen, "Unternehmerfreiheit", see note 116.

129 See discussion of the high audit rate for the earned income credit under I.R.C. §32, see note 22 and accompanying text.

130 Compare Trump's remarks, see notes 15 and 16 and accompanying text. Many moderate- and low-income taxpayers even support repeal of the estate tax they never will have to pay, a repeal that may be contrary to their own economic interests, just because of anti-tax rhetoric.

evasion. With the limited exceptions of the earned income credit,[131] various small family credits[132] and, if they are fortunate enough to have sufficient income to carry a home mortgage, the generally available mortgage interest deduction,[133] these are not the taxpayers who may capture significant legal tax subsidies. They may be taxpayers who conclude that if it is all right for wealthier individuals to avoid taxes, it only is fair that they of moderate means also should seize every opportunity to avoid tax. The increasingly blurred distinction between legal and illegal tax minimization may escape taxpayers' understanding or they may choose to evaluate the tax evasion opportunities on the basis of risk of detection and punishment – self-help tax minimization if the risk of detection and punishment seems remote. Given the opportunity not to pay a tax, taxpayers do not pay even if not paying violates the law.

Failure to pay use tax on out of state purchases seems to be in that confused category.[134] Failure to report exchanges of services for services and goods also may fall into a realm of taxpayer uncertainty if not simple inattention to rarely enforced tax principles. Use of cash payments to avoid complex and time-consuming reporting obligations often facilitates completion of necessary tasks like home repairs when the worker prefers undetectable cash payments.

Nonpayment of taxes otherwise owed supplements lawful tax planning as an element of the culture of tax avoidance. Whether with simple, straightforward and obvious techniques, or creative, sophisticated structures that enable high-income and high-wealth taxpayers to diminish what otherwise might be their tax liability, failure to report strains collection of tax revenue. In addition to categorized tax expenditures,[135] some available to a wide range of taxpayers like the mortgage interest deduction and the earned income tax credit, some the focus of attention for creative tax planners (such as intangible drilling costs and complex financial products), there also is a substantial amount of potential tax revenue that escapes taxation because taxpayers fail to report income and overstate deductions. The IRS estimates that the amount of the revenue lost to nonreporting and the overstating of deductions for 2008–2010 runs to $458 billion annually.[136] This is the "tax gap." The tax gap measures noncompliance with the tax laws, as opposed to active but sometimes questionable reporting with tax planning, and it consists of all federal taxes: personal income, corporate income, estate and gift, excise and employment taxes. Repercussions from underreporting are few and no societal opprobrium attaches to such behavior. Instead, rank-and-file noncompliance tends to be socially accepted and acceptable behavior as taxpayers chat casually and openly about small-scale noncompliance with friends and acquaintances.

There are numerous nonstatutory opportunities not to pay taxes. Many of those nonpayments permanently escape taxation. Taxpayers regularly engage in economic activities and transactions but do not report despite the obligation to do so. The IRS estimates the voluntary compliance rate to be only 83.1 percent.[137] Absent withholding or third-party reporting, exclusions from and understatements of inclusions in tax bases are commonplace. The estimates of failure to pay self-employment tax are nearly five times as great as the employment tax because there is third-party

131 I.R.C. §32 and discussion at note 22.

132 Childcare credits under I.R.C. §21; child credit under I.R.C. §24.

133 I.R.C. §163(h)(2).

134 See Cohn, "More States", note 77.

135 See note 30 for Treasury estimates of tax expenditures.

136 IRS, "The Tax Gap: Tax Gap Estimates for Tax Years 2008–2010", available at www.irs.gov/uac/the-tax-gap. See generally M. G. Allingham and A. Sandmo, "Income Tax Evasion: A Theoretical Analysis", 1 *Journal of Public Economics* 323 (1972); S. Yitzhaki, "A Note on Income Tax Evasion: A Theoretical Analyis", 3 *Journal of Public Economics* 189 (1974); S. E. Agbi, "The Size of the Tax Evasion Problems on Self-Employment Income: An Examination of Effects of Tax Policies on Compliance", 2 *International Journal of Business and Management Review* 73 (2014).

137 Id.

withholding of the employment tax.[138] Similarly, overstatements of deductible amounts and tax basis are also common and reduce the amount of tax paid. For example, it is not unusual for a taxpayer who purchases an item at a charitable auction to claim a charitable contribution for the amount paid or a taxpayer receiving a benefit in conjunction with a charitable contribution to deduct the full amount of the payment to charity undiminished by the value of the benefit. Where the transactions involve payments for services, failure to report involves nonpayment of income tax as well as applicable employment taxes.[139] With respect to income taxes, much of that tax gap results from the underground economy where transactions consist of payments in cash or the bartering of goods or services. Often individuals exchange household services or pay for a household service in cash, and neither party reports the transaction. While the charitable claim and the payment for services may involve small amounts, they reflect anti-taxation and anti-compliance attitudes.

Without the banking system assisting the flow of payments, the transactions are difficult to identify and trace. Indirect methods of tracing payments by observing the spending behavior of individuals occasionally detect the failure to report income and pay taxes but are a vastly inadequate substitute for honest and complete taxpayer reporting and third-party information reporting. The culture in many countries, including the United States, does not stigmatize the failure to report completely and honestly. Rather the economic culture emphasizes avoidance of taxes as an acceptable choice whenever possible and imposes no moral obligation of tax compliance on the citizenry. Congress's reluctance to fund the IRS makes the resources necessary to detect tax evasion scarce and fortifies the perception that avoidance and even evasion of tax is acceptable behavior.

Conclusion – satisfying revenue needs

Tax avoidance and tax evasion shift the distribution of tax burdens from those with greater income and wealth to those least able to avoid or evade tax payment. Generally, individuals whose source of income primarily is wages that are subject to third-party tax withholding[140] and investment income subject to third-party information reporting[141] are least able to avoid payment of tax. Tax avoidance and tax evasion do not diminish governmental need for tax revenue. With limited exceptions like the use tax on out of state purchases, avoidance and evasion of tax historically has concentrated on the income tax.

The tax avoidance culture has exerted downward pressure on the progressive tax rates. Over the last several decades, maximum marginal rates of income tax have declined in the United States and Europe. In Europe, governments rely heavily on regressive value-added taxes collected throughout the production and distribution process and wage taxes collected from employers to replace revenue shortfalls.

While the United States has introduced new and increased fees for various governmental services that previously were cost free and has increased deficit spending to provide needed resources, it has not followed Europe's model of the value-added tax to produce federal revenue. Collection of income tax in the United States is critical to meeting revenue needs. Whether

138 IRS, "Tax Gap Estimates for Tax Years 2008–2010", Table 2, available at www.irs.gov/PUP/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf.

139 For low wage taxpayers, failure to report income from services may be detrimental since the taxpayers may not claim the earned income tax credits to which they are entitled under I.R.C. §32. See note 23.

140 I.R.C. §3402.

141 I.R.C. §6041–§6049.

economic growth with the accompanying revenue produced from taxing the income generated along with deficit spending will suffice to satisfy revenue needs in the United States in light of anti-tax pressures remains uncertain. Limited efforts to collect additional income tax from high-net-worth and high-income individuals do exist. The recent enactment of the Foreign Account Tax Compliance Act (FATCA)[142] does seek to identify high-net-worth US taxpayers[143] who are secreting assets offshore in jurisdictions with strong bank secrecy laws and compel those taxpayers to disclose their offshore assets and report their income from those assets. FATCA relies on information reporting by foreign financial institutions and imposes sanctions on the institutions that do not agree to disclose US beneficial ownership and report those owners' income from the foreign accounts. Since the United States taxes its citizens and residents on their worldwide income, coercing financial institutions abroad to identify and disclose beneficial ownership by US persons of foreign financial accounts was anticipated to generate revenue to offset additional tax expenditures. At the time of passage, FATCA was estimated to generate $8.7 billion over 10 years.[144] The IRS offered an offshore voluntary compliance initiative under that legislation.[145] The initiative trades freedom from criminal prosecution for tax evasion and some penalties for voluntary reporting and payment of unpaid tax to the United States. It encouraged many US taxpayers to disclose their offshore investments on which they were not paying applicable federal income taxes.[146]

Yet, other than major offshore investors subject to FATCA, detection of failure to report many small transactions is low risk and such non-compliance has become an accepted part of the culture of tax avoidance.[147] Absent ethical compulsion which seems largely absent, there is no compelling obligation to report and pay honestly when one will not get caught. While seemingly an enforcement problem, non-reporting and intentional, but low risk of detection, false reporting is more a cultural determination that, on some level, taxes are unfair and malevolent. Accordingly, if one can get away with not paying, non-payment is all right. In that cultural context, the tax administrator is an adversary, not an agent working for the benefit of all. That perception of the IRS in the United States has resulted in the demonization of the agency both by Congress[148] and segments of the public at large. Congress rejecting its own tax agency tends to legitimize anti-tax and anti-reporting behavior. In that legislative context, the culture of tax avoidance in the United States is unlikely to change and tax avoidance and evasion likely to flourish.

142 Generally referred to as FATCA, added as a revenue offset provision, Title V, 124 Stat. 97, of the Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-47, 124 Stat. 71 (18 March 2010).

143 Foreign accounts less than an inflation-adjusted $50,000 are not subject to the FATCA reporting rules.

144 Joint Committee on Taxation, "Estimated Revenue Effects of the Revenue Provisions Contained in Senate Amendment 3310, The "Hiring Incentives to Restore Employment Act," Under Consideration By the Senate, JCX-5-10 (23 February 2010), available at www.jct.gov/publications.html?func=startdown&id=3649.

145 See generally IRS, "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers" (2014), available at www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised.

146 IRS, "Offshore Voluntary Compliance Efforts Top $10 Billion; More Than 100,000 Taxpayers Come Back into Compliance", IR-2016-137, Oct. 21, 2016 (available at https://www.irs.gov/uac/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-compliance).

147 Although it is in fact not avoidance but evasion.

148 S. Dinan, "House Republicans Slash IRS Budget, Move Toward Commissioner's Impeachment", *The Washington Post* (24 May 2016), available at www.washingtontimes.com/news/2016/may/24/house-kicks-path-impeaching-irs-commissioner/. Members of Congress frequently disavow their responsibility for the tax laws in referring to the Code as the "IRS Code." M.Y. H. Lee, "Who Wrote the 'IRS Code'? Hint: It Wasn't the Internal Revenue Service", see note 127.

At local level, the tax avoidance culture and governmental inability to increase taxes has strained municipal budgets and led municipalities to enlist their police and municipal courts into revenue production. Police are encouraged to increase traffic stops for moving violations and non-compliant vehicles and to increase random stops to determine whether drivers are validly licensed. In all instances the focus is not on public safety but generation of revenue through the municipal courts' imposition of fines and court fees. The distribution of the fines and fees has tended to be regressive and possibly discriminatory because the traffic stop targets seem to consist disproportionally of people of color.[149] This revenue production development is exceptionally troubling. As the "tax" that they are, fines and court fees are not uniformly and predictably distributed. Instead distribution is arbitrary and undermines the citizenry's respect for the police and faith in the United States as governed by the rule of law.

To modify the tax avoidance culture is difficult but FATCA is an important step. Broad publicity that the IRS is targeting high worth individuals with FATCA may help to alter the perception among moderate and low income taxpayers that the wealthy can escape taxes, but the poor cannot. Expanded information reporting requirements on investment products and better funding for the IRS to provide more audit resources for the examination of high income taxpayers are critical to further diminish impressions that tax collection is centered on lower income taxpayers because high income taxpayers have the resources to resist taxes successfully. Along those lines adopting the European model for low and moderate income taxpayers that would make annual tax return preparation unnecessary for many taxpayers would eliminate most audits in the lower income ranges and moderate the tax collector as enemy characterization.[150] More uniform distribution of tax subsidies by favoring tax credits over tax deductions also would help and even better would be the diminished use of the tax system to deliver investment subsidies – a very unlikely change in policy. Nothing can be accomplished without the willingness of legislators to embrace the need to change the culture even if those changes impact their campaign donors adversely. Modification in thinking and rhetoric necessary to bring about those alterations in attitude seem remote possibilities. A more radical economic crisis that cannot be ameliorated with deficit spending may be required to bring about the required fundamental shift in legislative attitudes to enact sufficient pro-tax compliance and collection modifications to overcome embedded cultural opposition to taxation, including providing for an extensive pro-compliance advertising campaign. One might envision successful educational advertising similar to anti-drug, anti-smoking, and pro-seat belt use campaigns that helped to modify public behaviors.

149 Ordower, Warren, Sandoval, "Out of Ferguson", see note 126.

150 See, M. J. Graetz, *100 Million Unnecessary Returns: A Simple Fair and Competitive Tax Plan for the United States* (New Haven, CT: Yale University Press, 2008).