CIVIL AND CRIMINAL PENALTIES FOR SERIOUS TAX NON-COMPLIANCE: A REVIEW OF IMPACT EVIDENCE

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Introduction

Tax fraud has been largely neglected by criminologists. Though the boundaries between criminology and regulatory research have been elided in recent years, with a few prominent exceptions (Braithwaite, 2005, 2009; McBarnet, 1992; McBarnet and Whelan, 1999), tax has not even played a prominent part in white-collar or corporate crime literature. Yet the redistributive (in favor of the rich) policies of the George W. Bush Administration, the ‘dot.com’ bubble of 1998-2001, the collapse of Enron, and the economic crisis of the late ‘oughties’ (2008-10) have focused analytical and political attention on the hollowing out of State resources and the role of ‘secrecy havens’ in enabling (i) rich individuals and corporations to pay small amounts of tax, and (ii) more conventional white-collar and organized criminals to conceal both their schemes and the proceeds of their crimes. In addition to NGO campaigns against high-end tax avoidance (e.g. http://www.taxjustice.net), in 2008-9, a plea-bargaining official of UBS in the US and an informant from the LGT Bank in Liechtenstein have shown that many High Net Worth (i.e. very wealthy) Americans (and other nationalities) were actively assisted by some international banks to hold accounts overseas without informing their tax authorities, as those individuals were legally obliged to do. Public and governmental risk appetites or tolerance levels may reduce as we need to finance our public services and post-2008 bailed-out financial sector with a smaller corporate and individual taxpaying population. Despite an unannounced fall in the proportion of millionaires facing audit (http://trac.syr.edu/tracirs/latest/204/) and a relatively unintrusive auditing risk for financial services corporations, only 15% of which were audited in 2008 compared with 64% of all other large corporations (http://trac.syr.edu/tracirs/latest/207/), these pressures have also generated some re-evaluation of the optimal ways of dealing with suspected tax evaders in the US and the UK, with which we shall be principally concerned, and elsewhere.

Historically, in every jurisdiction, the vast majority of suspected tax evasion has been dealt with via civil and administrative mechanisms or by negotiated settlement rather than via the criminal justice system. This has been taken for granted as a routine for dealing with people who are viewed as be-
ing ‘not real criminals’ and as being amenable to the sort of graduated sanction pyramid developed by Ayres and Braithwaite (1992). In the US, tax fraud prosecutions totaled 1,368 in fiscal year 2008, an increase of 8.7 percent over the 1,259 such prosecutions reported for fiscal 2001: some 8 percent of the white-collar prosecution total (http://www.taxanalysts.com/www/tracreports.nsf/Lookup/7?OpenDocument).

The central aim of this article is to review what evidence exists for the impact of civil and criminal sanctions respectively upon serious tax non-compliance by individuals (hereafter SNC, a construct that lacks sharp definitional boundaries), drawing upon a study conducted by this author for Her Majesty’s Revenue and Customs (HMRC) in the UK. Although there has been substantial research and theory on tax evasion and compliance, there has been almost no separate focus on the SNC sub-population, and – as with general criminological theories - inferences about susceptibility to sanctions drawn from the generally law-abiding may not apply to intensive offenders. There are no scientifically defensible studies reviewed to date which directly compare civil and criminal sanctions for tax fraud,¹ though there are some - e.g. most notably Dubin’s (2007) review for the US Internal Revenue Service (IRS) based on state-level cross-sectional analysis for the period 1988-2001 - that examine the impact of significantly enhanced criminal sanctions compared with enhanced audit levels.² Dubin took a positive view of the relative impact of criminal sanctions, though in the light of its low

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¹ In principle, given the strategic view tax authorities globally take of the use of prosecution, it might be possible to conduct a long term randomised controlled trial in which some serious cases were allocated to criminal prosecutions and others were not – a policy that would cause outrage if applied to very serious harms in other spheres of ‘criminal justice’. However unless they were done at different times, it would be difficult to track the general deterrent or preventative effects that arose, because it might be too difficult to attribute effects to the particular measure. There are other measurable initiatives that one might monitor more rigorously, for example the state of belief, expectation and knowledge of risks and consequences of sanctions in the tax arena that are relevant to tax prosecution work. Likewise, the impact of publicity campaigns on both tax yields and whistle-blowing could be measured. (See also Wenzel and Taylor, 2004).

² But not, alas, of criminal compared with civil penalties – in Dubin’s study, the economic and social consequences of increased audit probabilities remain unspecified.
statistical significance, perhaps a slightly more positive view than the evidence warranted.³ Although corporations are ultimately run by individuals, the alignment of opportunities, risks and incentives may be different for companies. The policy implications of this will be examined.

A helpful general model of the determinants of tax compliance, against which consideration of the relative effectiveness of civil and criminal sanctions will be based, is provided by Kirchler (2007: 3), who argues that tax compliance consists of the following components (which I have abbreviated and rephrased slightly below):

³ The significance levels are much lower than would be needed to show definitively that criminal prosecutions made more of a difference than increasing audits. Dubin (2007) concluded that criminal investigation (CI) activities have a measurable and significant effect on voluntary compliance; that the mix of sentenced cases (for tax and money laundering violations) is not a significant determinant of tax compliance; and that incarceration and probation have more influence than fines on taxpayers. Simulations using estimated models showed that the direct effect of doubling the audit rate on assessed tax collections (reported amounts and additional taxes and penalties) was $21.7 billion, whereas doubling CI tax and money laundering sentences might increase assessed collections by $16.0 billion. He estimated the general deterrence or spillover effects from either audit or CI activities to be approximately 95 percent, in other words doubling the impact of direct actions. However, what is important for deterrence is perceptions of audit probability and forensic competence (plus a judgement about consequences), not objective audit rates. (Though changes in the latter should have an effect on the former.) An earlier study by Dubin (1990) concluded that self-reported taxes would have been $15.6 billion higher in 1986 had audit levels remained at their one third higher 1977 levels: but Long and Burnham (1991) criticised this inference, arguing that given that an audit programme was in place, other changes in enforcement resources made it difficult to determine the independent effect of varying detection probabilities.
A Model of Tax Compliance

Political perspective

Fiscal policy and tax system
(complexity of laws, tax rates, etc.)

Social psychological perspective

Mental (social) representations

- Tax knowledge and mental concepts
- Attitudes, beliefs, evaluations
- Norms (personal and social)
- Perceived opportunities to evade
- Fairness perceptions
- Motivation to comply

Decision-making perspective

- Rational decision-making
  - Audit probability, tax rates, income
- Psychological Aspects of Decision-making
  - Sequence of audits
  - Heuristics, biases, frames

Self-employment (paid cash in hand and paying taxes oneself)

Interaction between tax authorities and taxpayers

- ‘Cops and robbers’ versus ‘customer service’ orientation
Addressing the core policy objectives, even if the evidence were stronger on many of these components, we must distinguish between (a) the expressive moral component of the use of criminal law and (b) the practical impact of criminal prosecution (compared with other forms of sanction) on SNC behavior.

**Principal lines of literature review**

The evidence examined falls into three core categories:

1. **Legal articles** that typically examine trends in the overlap between civil and criminal sanctions, but do not examine the effects on taxpayer or other criminal behavior or sanction awareness of either or both forms of sanction. A profound socio-legal review by Mann (1991: 1798) notes:

   ‘Punitive civil sanctions are replacing a significant part of the criminal law in critical areas of law enforcement, particularly in white-collar and drug prosecutions, because they carry tremendous punitive power. Furthermore, since they are not constrained by criminal procedure, imposing them is cheaper and more efficient than imposing criminal sanctions.’

   Learned reviews of jurisprudential principles (e.g. Mumford and Alldridge, 2002 on the tax/proceeds of crime overlap in the UK) are not reviews of the impact of law or operational practice upon the behavior of taxpayers. For these reasons, this review will spend little time reviewing the legal literature.

2. **Economic analysis** of expected impacts of measures, oriented towards either
a. neo-classical models which treat taxpayers/non-taxpayers as isolated individuals, and develop predictions about what one might expect rational persons (and, more rarely, firms) to do; or

b. some variant of behavioral economics, acknowledging cross-national variations in ‘tax culture’; group effects (in which individuals’ propensity to evade is affected by what they believe others are doing and will react to knowledge of their misconduct); and the contribution made to evasion and tolerance for it by the administration of and interpersonal skills of tax enforcement (e.g. Australia v. US);

3. The application of criminological deterrence/restorative justice models to tax enforcement, for example acting on beliefs about the fairness of taxation levels and treatment of taxpayers. This is sometimes combined with empirical observational and/or experimental analysis of how people talk about tax evasion and about tax agency behavior. This category can be part of 2 above, though the language may differ.

No model can sensibly determine in aggregate form the level of intentional or recklessly dishonest serious non-compliance (i.e. tax crime), which has to be analyzed case by case, perhaps using precedents to predict outcomes in sets of analogous cases. Let us begin by focusing on tax decision-making by individuals, refining this in the light of powerful evidence that our individual decisions are affected both by normative influences in our environment and by the extent to which professionals are available to help us to evade if we are disposed to do so.

**The taxpayer as amoral calculator**

The central orientation of the early economic models is that of the taxpayer-as-gambler (TAG), which is similar to the ‘amoral calculator’ type in general business regulatory studies. This TAG model makes the following four propositions (Cowell, 2002): (1) if the rate of return to evasion is
positive, everyone evades tax; (2) people with higher risk-aversion tend to evade less; ⁴ (3) people with higher personal income tend to evade more; (4) increasing any of the standard tax-enforcement parameters (the probability of audit, the proportional surcharge on evaded tax and the tax rate) will reduce the amount of concealed income. However, empirical evidence casts doubt on these propositions. US Taxpayer Compliance Measurement Program (TCMP) evidence suggests that a firm’s compliance is positively associated with being publicly traded and belonging to a highly regulated industry; whereas having low profits relative to the industry median is correlated with higher corporate tax evasion. ⁵ Cowell (2002: 11) argues that a rational taxpayer’s current tax evasion is a decreasing function of evasion in previous periods (essentially because if caught, he will receive penalties for previous years’ non-compliance): however if individuals – taxpayers with or without assistance from professional advisers - rightly or wrongly regard themselves as exceptionally sharp, and/or if they become addicted to cheating and believe that raising (or lowering) their tax admissions will bring suspicion (and investigation/further sanctions) upon themselves, then prospective risks of having to make back-payments may not lead them to desist. This may hold even more strongly for individuals in corporate settings whose annual bonuses and stock prices may receive strong ‘performance boosts’ but against whom tax investigations may occur only years afterwards – if they arise at all – often after they have left the corporation. Personality abnormalities characteristic of major fraudsters generally may occur at the high end of the SNC population, and commercial sociopathy may be stimulated by aggressive business and professional cultures or by pressures from ‘organized crime’ (e.g. Value-Added Tax/carousel/excise frauds in Europe, carried out by professional teams) that create and sustain ‘markets for tax vice’ (Braithwaite, 2005; Levi, 1994).

It is a truism to assert that evasion is likely to be influenced by the consequences of tax compliance for the individual. One implication of Kahneman and Tversky (1979)’s prospect theory and Kahne-

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⁴ This carries the risk of tautology unless one measures risk aversion to exclude willingness to evade.

⁵ It is moot whether the low profits are the result or the cause of higher evasion tendencies.
man’s (2002) general behavioral economics work is that people are usually highly averse to reduction in income or expected benefits, and are more influenced by fear of loss than prospect of gain. They describe a certainty effect whereby where no loss is expected, people exhibit a preference for a sure gain over a larger gain that is merely probable; while where a loss is in prospect, there is a risk seeking preference for a loss that is merely probable over a smaller loss that is certain. This has implications for reactions to asset recovery/tax penalties: these might be a greater deterrent if one has substantial assets other than those obtained from crime – otherwise all one loses is that which one has unlawfully gained, minus in practice gains already spent. The decision facing an individual as to the costs and benefits of civil vs. criminal prosecutions would entail weighing a higher probability of being caught alongside a smaller loss if caught for civil prosecutions against a lower probability of being caught but a larger loss (of liberty, though probably no greater financial penalty) for criminal prosecutions. If taxpayers knew for certain that they would be caught, then prospect theory would suggest that they are more likely to take risks in evading more if they faced certain prosecution than if they faced certain civil investigations. However if expected gain drives the decision to behave, and the taxpayers cannot know at the point of deciding to evade whether they will be subject to civil or criminal proceedings if caught, behavior in the domain of losses is unlikely to be relevant in considering the impact on deterrence.

Expectations of and concerns about stigma are also related to expected occupational consequences: getting any sanction on one’s record means more for those who need security clearance or authorization as a ‘fit and proper person’ to continue their careers, and means comparatively little to people who can operate in the background using ‘front men’ (or still, more rarely, ‘front women’). A criminal record is likely to do more damage than an administrative ‘record’ to elites and is more readily picked up by foreign authorities: however even a formal recorded sanction may have negative

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6 For example, like the former UK Prime Minister’s son, Sir Mark Thatcher, they may be denied a visa for the US; or may be prohibited from company directorships in countries (such as continental European ones) that apply such bars on people with criminal records. (Though practical effectiveness of such controls is dependent on easy cross-border data exchange.) To her astonishment, in 2008, home improvement guru Martha Stewart
effects on their careers, if and only if it is communicated to relevant parties such as financial services regulators or security clearance bodies. A criminal record or a regulatory penalty mentioned in a newspaper article might be picked up by electronic newsgathering and be incorporated into worldwide due diligence searches subsequently. Here, the fact that non-criminal tax penalties are almost invariably unpublished reduces significantly the collateral damage to those sanctioned. There is a personality dimension to the desire for approval or fear of disapproval by others, which can be important to decisions to offend within the context of expected adverse/tolerant reactions. However some important changes in late modern societies in the nature of status and in the ability to insulate oneself from other groups have brought extra complexity to the task of social regulation and to deterrence by informal sanctions.

The subjective opportunity cost of any given sanction may vary among individuals, even though the actual sentence may be the same for all (see further, Cook, 1980, 1986; Nagin, 2007; Bushway and Reuter, forthcoming). As for general deterrence, communication of enhanced risk via an active public profile for sanctions might increase the chances of people recalling a ‘bad event’ if they contemplate tax evasion7 (though this may be hard to implement).

In the criminological version – ‘rational choice theory’ – people maximize their utility given the situational opportunities that confront them, a notion that has been modified to take account of variations in cognition and creativity in spotting fraudulent opportunities that others may not have done, sometimes in collaboration with professional advisers and sometimes not (Levi, 2008a). However it is not self-evident what choices will be seen as ‘rational’: economic models do not pre-specify whether outwitting the tax authorities or other groups, despising conventional bourgeois tax morality, or following national or transnational industry norms of ‘maximising tax planning’ are utilities to

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7 In prospect theory, this is called the ‘availability heuristic’, i.e. something that is available in the mind to assist decision-making, in this case whether or not to evade taxes.
be maximized or to be minimized as part of sentiments of social obligation which, despite globalization, may vary between countries.\(^8\) In international business circles, competitive pressures may stimulate (or be used as an excuse for) the ‘race to the bottom’ in tax minimization, legal or illegal. As Shover and Hochstetler (2006: 116) put it: ‘Choices...occur in sequences and change as circumstances develop. Moral reservations and internal inhibitions are subject to situational suspension or inattention.’ One case cited (p.113) involved a physician who did not file a tax return. He stated that post-divorce: ‘I was trying to drink myself to death. I did not care about the government and did not think about the trouble I could get it. It totally did not matter to me.’ Simpson (2002) demonstrated that risk perceptions and opportunities for advancement and thrills predicted the intention to offend in a variety of business crimes. Other factors influencing the intention to offend included an ethical reasoning scale, anticipated shame and informal sanctions. Threats of formal sanctions – civil or criminal – were not strong deterrents unless combined with low moral principles; those with high morality and social embeddedness were unaffected by low sanction risks.

Hessing et al. (1992) notes that some need only a small amount of deterrence to keep them honest; others need none at all (because of personal or socially generated morality – see Wenzel, 2004); and others still are totally dismissive of threats, whether because they are fearless or perhaps because they are preoccupied with how to recover their losses. (I would posit that arrogance may play a part in fearlessness.)

However evidence from the US is that taxpayers possess poor knowledge of the audit rules and risks, usually overestimating the probability of audit (Andreoni et al. 1998: 844, 845). Such variable awareness of law and or detection risks is quite common among offenders generally, and is an important issue in game theoretical simulations of tax evasion. Rationality is always ‘bounded’ not just

\(^8\) Braithwaite (2005) reviews variations on aggressive tax shelter and scheme promotion between Australia, the UK and the US, and even within different cities in Australia. It is interesting to consider the effect of the KPMG partners’ prosecution and convictions in 2008 upon the tax culture there and elsewhere. Note that both KPMG and Ernst & Young corporately benefited from ‘too big to be convicted’ deferred prosecutions, despite involvement in highly abusive ‘tax planning’.
by knowledge of abstract probabilities but also by variable beliefs about and concern with the reactions of others to knowledge of one’s involvement in ‘crime’. These may vary over time and place, and are also affected by the prospects of migration to places where one is unknown, even if one does not change identity which, especially with money, is usually possible.

Discussing field experiments, Slemrod (2007: 38) concludes that ‘there has been no compelling empirical evidence addressing how noncompliance is affected by the penalty for detected evasion, as distinct from the probability that a given act of noncompliance will be subject to punishment.’ This is consistent with the evidence from general studies of deterrence.

Data suggest plainly that the ‘amoral calculator’ or TAG model is simply wrong and that the model requires refinement. Frey (1997) and Braithwaite (2005) suggest that increasing punitive tax enforcement may reduce compliance because of ‘civic virtue’: but it is questionable whether this applies to SNC. In the context of evasion and sanctions, even where people contemplating evasion see the costs associated with both civil and criminal prosecutions as high, those costs may be seen as arising far in the future. One UK government economist observed to this author (personal communication, 2008):

“tax evaders see immediate benefits whereas the costs which remain uncertain are unlikely to arise soon after the offence has been committed, if at all where the offence is not detected. This behavior may be particularly visible in risk seekers who are more likely to discount future potential costs. This then implies that we would want to focus on catching evasion quickly and not rely on the fact that we can look back and deal with the consequences of evasion that has occurred in the past.”

How does this apply to business tax compliance and evasion? Here the research is sparse. In principle, businesses can be either (a) mere fronts for the perpetration of fraud or (b) genuine businesses that evade tax as part of their repertoire of profit-making, whether or not in response to declines in
profitability. (As with my earlier typology of individual involvement (Levi, 2008a), businesses can turn from genuine trading ones to mere instruments of tax and/or perhaps other forms of fraud, making ongoing risk monitoring crucial.) Control strategies should reflect to which of these categories (themselves containing ranges of fraud) the firm belongs. We might expect large public companies to act in a risk-neutral manner, rather than like the risk-averse individuals in the Allingham and Sandmo (1972) model. To align the incentives of the decision makers and the shareholders, the corporation should tie the agent’s compensation to observable outcomes that affect post-tax corporate profitability: but as with general corporate regulation in the ‘bonus culture’ responsible for much of the financial crisis of 2008-10, this requires serious attention by corporate governance and regulation. Crocker and Slemrod (2005) note that enforcement strategies directed at the tax adviser and those directed at the corporation itself may impact business behavior differently. (Though Braithwaite, 2005, makes the interesting point that Australian taxpayers whose schemes were disqualified late in the day by the Australian Tax Office blamed the ATO rather than their tax advisers: part of his more general argument about the importance of legitimacy, to which we now turn.)

**Stigma, Reintegration and Deterrence**

There is always a tension between (a) frightening people with credible threats of formal and informal sanctions, and (b) reducing social exclusion and promoting social reintegration, giving people an incentive if they want to rehabilitate themselves. Part of the subjective evaluation of consequences in the decision to offend is the judgment they make about what the potential penalties on offer might mean to them.

For Karpoff and Lott (1993), as perhaps for the theory of reintegrative shaming developed by Braithwaite both generally (1989) and in relation to regulatory and tax compliance (2002, 2005), fairness vis-à-vis penalties in non-white collar crime cases and satisfying small investors and the general public that the authorities are combating ‘unjust enrichment’ is irrelevant. Re-integrative sham-
ing may have to deal with punitive denunciatory sentiments, and this may conceivably be achieved by persuading victims (if any) and the public that the offender has atoned and will sin no more. A longitudinal study of US Federal ‘white-collar’ offenders⁹ (Weisburd et al., 2001: 113) found that imprisonment had no significant effect on recidivism compared with fines or probation (though civil or administrative sanctions were not examined in this study). This ‘no difference’ finding applied irrespective of timing, frequency or type of recidivism.

The sort of people who are engaged in serious non-compliance may find it comparatively easy to migrate to a ‘flight haven’ jurisdiction in which tolerance is high, at least so long as they retain their money. The itinerant career of the late Robert Vesco – who lived, worked and invested serially with senior public officials and their relatives (‘Politically Exposed Persons’ in anti-money laundering terminology) in Costa Rica, the Bahamas, Antigua, Nicaragua and Cuba, while evading the US authorities on a variety of fraud charges - is merely one extreme illustration of this toleration of the wealthy. (Though even his – or rather, his creditors’ - money ran out in the end). Pending major changes from pressures in 2009-10 within the G20 for greater routine as well as post-‘reasonable suspicion’ or post-indictment tax information-sharing (OECD, 2009), tax investigation powers have fallen far behind the general trends in sharing suspicious activity reports among Financial Intelligence Units and mutual legal assistance in criminal matters that have been stimulated by the Financial Action Task Force’s anti-money laundering efforts.

**Legitimacy, publicity, awareness and tax evasion**

In short, a narrow focus upon particular sanctions applied to people or companies who are already SNCs or other forms of criminal can neglect the important dimension of social legitimacy to behavior, whether that behavior is paying taxes, corruption or perceptions of the police (see Tyler, 2006;

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⁹ Because of the breadth of the ‘wire fraud’ category in the US Federal law, ‘white-collar’ was in fact a mix from elite to mostly blue-collar people involved in scams and credit card frauds.
Tyler and Degoey, 1996). Alm et al. (2008) concluded that the tax authority would be served by pre-announcing audit rates credibly (though they do not show how such credibility can be achieved) and by emphasizing the previous period audit frequency in annual reporting of enforcement effort: as noted also by Dubin (2007), increasing audit levels creates a substantial ‘ripple effect’ to those not audited. However there may be ‘core’ groups or individuals who are not disposed to pay taxes and/or to set up complex fraud schemes, for whom general ‘appeals to conscience’ are irrelevant because they do not work on psychopaths (Babiak and Hare, 2007).

Models in the economic and regulatory literature fail to distinguish adequately between sub-sets of the tax-violator/taxpayer population, and this is important to tax authorities. In common with other more general regulatory analyses, the models assume some sort of market viability, rationality and social embeddedness that makes it sensible to apply a ‘pyramid of enforcement’ (Braithwaite, 2002 – see also Macrory, 2006), in which sanctions are escalated if people and organizations fail to respond to lower level sanctions and informal advice, apparently optimizing enforcement costs per (mis)behavioral unit. It is correct that a blanket criminal justice model (practiced nowhere in the tax or regulatory arena) would impose resource costs that are unavailable and disproportionate upon those who would respond to less costly sanctions. However graduated sanction models are destined to fail with pre-planned offenders whose businesses are not otherwise viable, and may leave too late the identification of intentional organized fraudsters (individual, networked or corporate) and the prevention of their frauds. On the other hand, even in the case of the latter categories of ‘conscious opponents’ of the tax regime, criminal justice alone cannot put an end to their crimes: for prevention, one must also look at the possibilities of disguise of beneficial ownership and shadow directorships; and perhaps at better explanations of decisions that communicate the moral difference between categories of serious non-compliance, e.g. ‘theft from the public’ in the case of businesses that are or have become mere instruments of fraud, and ‘decision not to meet all their legal and so-
cial obligations’ for SNC by otherwise legitimate corporations who may have heavily invested in their respectable social profiles.¹⁰

In reviewing costs and benefits of criminal sanctions, there is an important balance to be struck between (a) administrative convenience (resource costs); (b) outward-facing demands, some of which are more consistent and reasoned than others, to ‘satisfy the public’ (or their distorted proxies, the media) that justice has been done and that the bad (especially the ‘very bad’ as seen by the public) have been punished; and (c) behavior-changing sanctions. In North America, the UK and the Netherlands where (unlike some Continental European jurisdictions) prosecution is optional even after the evidential threshold has been reached, there is always in principle a choice to be made about what is in the ‘public interest’; but many people believe that wrongdoing should normally lead to punishment and to criminal justice. To others, the criminal law is just one mechanism among others for achieving a ‘reasonable’ level of compliance (and/or payments due to or from the State); and it is arguable that the optimal level is where the marginal benefits of revenue-generation just exceed the costs of enforcement.

In principle, one might have an approach that distinguishes in sanctions and ‘control routes’ between

1. those who commit large scale tax fraud and are part of more general serious crime networks;

2. those who evade tax via substantial non-declaration of income from crimes other than tax fraud;

¹⁰ Pragmatically, one must accept here that the media cannot always be persuaded to publicise HMRC’s attempts to rebut corporate PR – except by paid advertisement – and the public may not always be persuaded to read or listen to such rebuttals.
3. those who act more or less in isolation from general crime networks but are involved in very high level tax fraud (using corporate or other intermediaries as vehicles for fraud); and

4. those who have ‘modest’ amounts of undeclared income or over-declared deductions against tax.

In the US, but less so elsewhere, there are also ‘underground’ movements that claim a principled refusal to pay tax. Actor Wesley Snipes claimed membership of one such movement and was acquitted of felony tax evasion charges, though he was convicted of and imprisoned for three misdemeanor counts in 2008.

In terms of amenability to control, it is also helpful to distinguish between (a) those SNCs that have the capacity to pay proper taxes from their assets or profits (and against whom civil measures would plausibly generate such repayments and penalties, at least if international cooperation were available), and (b) those SNCs that would not survive if they had to pay a legitimate level of taxation. The latter - (b) - have to be closed down by whatever means, civil and/or criminal, as early as practicable and as early as is ethically, legally and pragmatically defensible to reduce the risk of mis-allocation and to satisfy public/business expectations of legitimate intervention. Setting aside problems of cooperation and transparency in other jurisdictions, there is no reason why such a typology cannot lead to differentiated sanctions. However one complicating factor in this equation is that tax fraud cannot be treated solely in isolation, for at least three reasons:

1. Some tax fraudsters who are part of the ‘professional’ or ‘organized’ crime networks may be calculating the costs and benefits of tax fraud relative to other frauds and non-fraud crimes that they have the skills and resources to commit;
2. There may be some displacement effect (in either direction) both on a national and an international basis, arising from arbitrage of perceived detection and punishment probabilities in different jurisdictions;¹¹ and

3. There may be some general demoralization/tax non-compliance effect through comparisons of how leniently (or apparently leniently) tax fraudsters are treated compared with social security fraudsters in particular and ‘working class/underclass’ offenders in general. Non-tax and lower-level tax offenders may also seek to justify their conduct – to themselves and to others – as being low in seriousness compared with the unprosecuted crimes (including tax crimes) of elites.¹² Fairness matters.

These observations raise the issue of what counts as ‘success’ in enforcement regimes. A beggar-my-neighboring-department model might generate the aura of success against narrow objectives, but externalities impacting on the public (whether citizens, residents or taxpayers, depending on context) might be considerable. In seeking to develop a dynamic model of ‘fitness for purpose’ of sanctions, a refined problem-oriented policing model of the ‘triangle of crime’ comprises three elements: (1) suitable targets; (2) motivated offenders; and (3) capable guardianship (by tax authorities and other gatekeepers such as national and international employers, neighbors, tax advisors, bankers, etc.). Attitudes to tax fraud/evasion are important components of crime in the context of motivation and guardianship, though we should add that the seeing of opportunities to evade tax may also involve the technical imagination of people willing to offend but not always knowing how to do so. Evasion techniques may be supplied by others (including professional advisers) – who for self-protection may not advertise to all willing tax evaders - or may be the result of introspection. The

¹¹ The role of professional advisers, the media (including professional publications) and social/professional network rumours are important here. There is likely to be considerable informational asymmetry, and some professionals may keep their extensive knowledge of HMRC to themselves as an ‘asset’ to market to clients.

¹² The causal impact of such perceptions is hard to determine: but the moral effect of controls is diminished by their ability to point to tax and other frauds by relatively well off people.
evidence is insufficiently clear to permit inferences about sub-sets of tax evaders at this stage, except for rather obvious things that apply to the extremes: but it is worth noting that interactive impacts between taxpayers based on what they believe (rightly or wrongly) about (i) levels of evasion and (ii) the risk and consequences of sanctions, are an important component of the ‘mix’.

Conclusions

This review comes at a significant juncture. There will also be greater pressure to extract more taxes from companies and wealthy individuals, as the gloss is stripped from the deregulation culture and the economy moves into retrenchment mode. Seriousness of non-compliance can relate to large individual or linked cases; to the professional and social status of the people involved; and/or to the rate of increase (or – via media accounts – perceived rate of increase) of a scheme triggering alarm at the erosion of a major public income or expenditure scheme. Nor empirically is it clear that the comparison is like-for-like. The impact of civil penalties that were publicized – and expected or known to be publicized - might be very different from the current anonymous civil penalties, when imposed on those sanctioned and via general deterrence.

The term ‘impact of publicity’ itself needs clarification: it may occur in specialist professional publications (tax advisers; construction newspapers); business papers and electronic programs (Financial Times; Wall Street Journal; Bloomberg); national mass media; and local media. Media coverage in tabloids may have little effect on elites (unless it also affects consumer demand or credit facilities, or their ‘fit and proper’ status as directors or professionals), but may have significant effects on the popular sense of ‘Justice for All’. Coverage in the specialist and professional press may produce stigma and fear of stigma among some or all actual and potential evaders, but leave unaffected mass opinion about equality of justice and the legitimacy of tax enforcement. If it is correct that (non)taxpayers will pay more in civil penalties than they would as a criminal penalty (legal fees being constant for the purpose of this illustration) in order to avoid conviction and publicity, then the ar-
argument may take a different shape from a situation in which 3% of the total tax evasion identified is recovered, as observed by the UK Public Accounts Committee (2008: 14), which also noted that there was no (formal) sanction of any kind in half of the cases. If the lifestyle asset recovery provisions of the Proceeds of Crime Act 2002 were implemented or even credibly threatened in tax fraud cases, perhaps the recoveries and deterrent effects would be greater still?

But whatever the boundaries of ‘serious non-compliance’ (SNC), it is important to differentiate between impacts of civil and criminal processes on (a) those individual and organizational SNCs that have been identified and (b) the pool of currently unidentified actual and potential SNCs. One way of thinking about this is in terms of impacting not just on ‘tax offenders’ – those who are considered to have significantly under-declared income or over-declared expenses - but also on the infrastructure of facilitators and inhibitors of SNC behavior – ‘enablers’ in contemporary organized crime terminology. There are some relatively undeveloped interviews with imprisoned Australian tax offenders (Roche, 2006) that yield some insights about the importance of procedural justice and the relatively greater impact of economic informal sanctions compared with the pains of imprisonment.

Roche’s study is short on detail (not just because of anonymization), but crucial for our purposes is that these do not appear to be very high-evading or corporate offenders, not least because the Australian Tax Office very seldom prosecuted the latter before the period of his research.

A proper model of fraud committed in a business or professional context (see further, Levi, 2008a) should differentiate between:

1. Pre-planned fraudsters, who set out with the initial intention of defrauding (though the scale of their ambition may vary, as is their need for active collaborators and skills);

2. Intermediate fraudsters, who start out honestly but turn to intentional fraud later; and
3. Slippery-slope fraudsters, who may commit offences of deception (and insolvency fraud) while, in their own eyes at least, merely seeking to carry on their previous business; or may just carry on incurring debts (including their own living expenses and tax obligations) at a time when they are unable objectively to repay.

Such differentiation is absent from the literature on tax fraud and indeed on tax compliance generally, though findings applicable to sub-sets may be masked by looking at measures applied to the entire (or at least a broad) population of offenders.

The argument about the appropriate use of the criminal sanction also has a moral dimension which is not reducible to scientific evaluation of effects. We criminalize acts because we consider that they are morally wrong and deserve public sanction, not just as a pragmatic technique for controlling the behavior more effectively (though ‘we’ – politicians, public and academics - may believe or like to pretend that the criminal justice process has this effect because we have an appetite for dramatic action). It is intriguing to consider how the prosecutions and penalties regimes would differ from the present ones if the UK or US had a unified body prosecuting and/or sanctioning all frauds against the government. Given that for some elite and perhaps non-elite suspects, ‘the process is the punishment’ (Levi, 1993), to what extent, for example, should we take account of the secondary consequences of arrest, charge and sentence for the particular offenders when deciding what form of action to take? Tax evaders interviewed by Roche (2006) said how upset they were by the delays they faced in the criminal process, though (undiscussed in his paper) one might question it is not obvious that knowledge about this would have made them less willing to evade tax. The inter-agency consistency issue keeps re-emerging in tune with the ‘social fairness’ question that cuts across internal bureaucratic rationalities in different countries.

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13 The question of how we can properly calculate these secondary effects is a very difficult one to answer. Sociopaths may simulate well-integrated people and incorrectly get sympathy and reduced risks of prosecution and sanctions: that is their tradecraft.
How we choose to punish such behaviors, once subjected to the criminal sanction and convicted, then depends on whether we advocate retribution (punishing according to both culpability and harm) or a purer form of utilitarianism (punishing according to what impacts ‘best’ on the behavior of the defendant and others) constrained perhaps by the relative costs of different sanctioning options. But how we handle serious non-compliance may influence as well as reflect how seriously this misconduct is regarded: for example, if it is seldom prosecuted or imprisoned, it may be easier for those with tax evasion opportunities to rationalize serious evasion as ‘not really harmful’. And those who commit smaller but still significant offences may be able to rationalize their conduct to themselves and to at least some of their peers as ‘non-serious’ by reference to larger, unprosecuted cases (Henry, 1978; Levi, 2008a; Shover and Hochstetler, 2006).

In looking at the practical implications of international evidence, though the discourse of economic analysis appears to be culture-free, care must be taken (as in criminal justice policy transfers generally) that account is taken of cultural differences within and between countries when adopting models on the basis that they ‘work’ or ‘do not work’ somewhere else: ‘what works’ is always contingent on context.  

Unfortunately, hard evidence of the relative impact of civil and criminal sanctions on tax (or other) offenders does not appear to exist, and even absolute impacts of either civil or criminal sanctions are absent. One form of financial sanction is of course the confiscation (or asset recovery) order, but though there is some anecdotal research in the UK (Levi and Osofsky, 1995; Matrix, 2007) that suggests that serious mainstream criminals (and their families) are especially upset by the prospect of

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14 Though their analysis was carried out in the UK, Hasseldine et al. (2007: 190) suggest an appropriate caution of ‘what works’ in relation to the strategy of sending different sorts of letters to taxpayers: “Future research needs to consider the long-term effects of normative and sanction-based persuasion strategies. For example, if returns from the “preselected audit” groups were not actually audited, the idle threat would most likely lose its effectiveness. Similarly, threats of increased audits and penalties could become meaningless if there were no subsequent data supporting those threats. Another issue is whether multiple letters (year after year) would eventually be disregarded if the recipients themselves are not audited. Furthermore, would the long-term effectiveness for normative appeals decline or continue to increase?”
losing their assets, this falls short of hard evidence of its individual or general deterrent effect. Our desire to find something that ‘works’ may lead to over-optimism in judging effectiveness. For example, in the light of long experience of RICO and other confiscation since the early 1980s, one might have expected most serious offenders to have long since desisted from crime in the US. This is not the case.

Civil sanctions may be cheaper to resource, faster and more predictable than criminal jury trials: that is their chief attraction to both enforcement body and ‘offender’. Their disadvantage is enhancing actual and perceived social unfairness between classes of offender (where other less serious offenders are prosecuted for different sorts of crimes), especially if no negative publicity attaches to the ‘offender’. Stigma (with or without prison) is more of a deterrent to those who consider that they have something to lose, primarily those embedded in networks of respectability. Such a logic applies whether people are businesspeople or are wife-batterers with a stake in respectability (Sherman and Smith, 1992). However apart from the issues surrounding public attitudes to fraud in general and tax fraud in particular, serious planned fraudsters are likely to be sociopathic individuals who do not need (or feel they need) respect or affection (Babiak and Hare, 2007), and who feel that if they want those ‘commodities’, they can buy them. It is a fundamental mistake to believe that sanction-logic applicable to middle-class and elite conformists can be applied to professional fraudsters who might prefer social approval (or the absence of public disapproval) but are not dependent on it. On the other hand, it is also the case that corruption and inadequate surveillance by prison staff sometimes enable the continuation of serious crime activities from inside prison (Blakey, 2007), so the incapacitation as well as deterrent effect of imprisonment can be overstated.

Although scientific evidence may bear upon some components of the tax control role, some of the core aspects of the civil versus criminal process debate are really policy questions about how much of a role the tax agency wants to give to the public display of disapproval of particular tax evasion practices and to issues of social fairness – ‘equal punishment for all serious offenders’ – rather than
to the (probably) less expensive and quicker civil mechanisms. Some hybrid models – as in publicly announced disciplinary tribunals in financial services and the professions – may combine some positive features of both, but may reduce the incentives for serious tax violators to settle quickly. On the other hand, if actual and potential SNCs overestimate the risks and consequences of tax sanctions at present, then the publicity might have no increased deterrent effect. The present state of evidence does not tell us how different sets of potential SNC offenders perceive these trade-offs.

Let us review the policy questions set out at the beginning of this review.

1. The preventive effects of civil and criminal sanctions in changing the behavior of those who are directly subject to a sanction. From the tax or criminal careers literature, we know almost nothing about recidivism rates, except among those who - as a result of professional sanctions such as being struck off as chartered accountants, barristers, or solicitors - are incapacitated from performing prior roles of facilitating SNC. Examples include the American KPMG staff convicted in 2008 in relation to tax shelters, and who in consequence were struck off from practicing by their professional bodies in the US. The licensing consequences for those barristers and other professionals detected for what presumably would be counted as SNC (PAC, 2008) are also intriguing: are these details passed on to the professional regulators or just filed in the tax agency’s records, leading to greater scrutiny in future (and presumably having some deterrent effect on those sanctioned, though – assuming discretion by them in not broadcasting their encounters - not having any marginal impact on any others)? Although they can still function as covert advisers, fees paid to such persons arguably would not be tax-deductible and their advice would not carry the legitimacy granted to professionals working for prestigious firms or as independent counsel, which is an important part of what clients are paying for.

2. The effect of criminal sanctions (including custodial and other forms of sentence) in deterring those potentially prone to engage in serious non-compliance. There is some evidence of im-
pact compared with increasing audit rate alone, but the literature on ‘procedural justice’ emphasizes that the reasons why an institution’s rules and regulations are obeyed or disobeyed form an important consideration for regulatory agencies. The use of threat and legal coercion as a regulatory tool—in addition to being more expensive to implement—can sometimes be ineffective in gaining compliance. Using survey data collected from 2,292 Australian taxpayers accused of tax avoidance, it was demonstrated that variables such as trust need to be considered when managing non-compliance. If regulators are seen to be acting fairly, many (though not all) people will trust the motives of that authority, and will defer to their decisions voluntarily. If the general body of taxpayers are to be distinguished from the criminal/punitive civil treatment of ‘hard core’ suspected SNC companies and individuals, some effort needs to be made to explain this to both sets if the trade-off between legitimacy and deterrent action is to be optimized.

3. The effect of civil sanctions (e.g. penalties, orders and insolvency powers) in deterring those potentially prone to engage in serious non-compliance. Here, there is no real publicly available evidence. Incapacitation of those companies and their directing minds that have been identified can be achieved by mechanisms such as closure of companies and director disqualification, but only if there is subsequent surveillance to ensure that beneficial owners cannot re-appear using false fronts. This is linked to weaknesses in domestic and transnational anti-money laundering controls and problems of lifting the corporate veil. However whether such post-detection incapacitation also deters others depends on judgments about probabilities and consequences in terms of the personal norms of and economic opportunity costs to the potential evaders. If the start-up costs of serious tax frauds are low and the consequences of detection modest (e.g. repayment of tax owed), it is not obvious why those risk-oriented people would be deterred, especially if they do not expect bad publicity or do not care about it.
4. The impact of civil and criminal sanctions on levels of public confidence in the integrity and fairness of the tax system; and the subsequent benefits in preventing compliant taxpayers from slipping into tax non-compliance. The evidence from the ‘procedural justice’ movement suggests that such legitimation strategies do have an effect. Murphy (2005) argues that such an approach does not preclude deterrence and punishment. For example, someone who deliberately makes false claims on their tax returns or who shifts their money offshore to avoid tax should be reprimanded and punished. However, the manner in which the punishment process is handled should still be done in a way that is both respectful and fair. If regulators can learn to better manage the way their laws are administered, as well as learning to better manage public reactions to their laws, they will be able to turn some resisters into long-term compliers.

5. The role of publicity surrounding civil and criminal sanctions in maximising their impacts on deterrence and wider public confidence. No firm evidence exists about the impact of publicity in tax cases. One would need some ‘before and after’ research, including research on the effects of different levels and styles of publicity. What is needed is some evidence about what people in ‘target cultures’ believe about the risks and consequences of SNC, and a realistic strategy of publicity – free or paid for as advertisement - based around this. 88 per cent of executives in 1994 stated in surveys that they would react vigorously in terms of refusing to do business with people convicted of fraud (though they were more tolerant of those convicted of tax fraud). A substantial majority state consistently in successive surveys that they would also avoid socially those convicted of fraud against other people and investors: indeed, over a third stated that they would avoid them even if suspected of such frauds. But the effects of this depend on how much intending or more vaguely potential fraudsters care about such reactions (and on what they expect such reactions to be, given that few or no people they know
will have been subject to such reactions previously). Furthermore, in reality, there is the pragmatic factor of whether the tax evaders are seen as continuing generators of benefit for those who trade with them, and as disciplined people. The ‘reassurance policing’ impact on wider public confidence is likely to be greater from criminal prosecutions and from clearer statements about civil penalties than currently exist. But in both cases, attention should be paid to seeking to emphasizing the legitimacy of tax enforcement. As things stand, we know very little about what potential offenders or the wider public believe about the risks of sanction, civil or criminal, or what they know about what the penalties imposed, even in criminal cases that do receive publicity. As Walker and Marsh (1984) demonstrated, there is likely to be a significant gap between what the public can remember and what those of us who track cases in the media see as ‘good’ or ‘bad’ results in media coverage. A Canadian study showed that very few people had a clear idea of what sanctions were likely to be imposed, and found difficulty in relating to the kind of press notices sent out, but they wanted tough sanctions to be imposed in ‘big’ cases (Canada Revenue Agency, 2007).

6. Looking beyond the tax system, the role of civil and criminal sanctions for serious tax non-compliance in reducing wider criminality and social harms. There seems little doubt that objectively, without pressing too hard the Al Capone analogy, there is scope for using the tax system as part of the armory of social enforcement against antisocial behavior, whether the misconduct is by gangsters or by non-violent businesspeople. Setting aside bureaucratic and organizational politics, it may not matter for these practical purposes whether that asset recovery or incapacitation is achieved by civil or criminal mechanisms. There is no firm evidence of greater or lesser effectiveness from either mechanism.
One of the difficulties in thinking through the impact of different strategies and measures upon the forms and levels of serious tax non-compliance, as with other areas of serious harm, is that we have rather poor data on what typical ‘criminal career’ profiles of individuals and networks look like, against which to judge effects of our interventions. We know that there is an interactive effect generally between individual values, social norms and formal sanctions, and that – as with terrorism – legitimacy arguments are important alongside formal control measures, in reducing the pool of support for crime as well as the number of willing offenders. This review has highlighted in some places the international norm and mutual assistance aspects of control efforts: but deterrence is never likely to be as effective as prevention. In the particular case of tax, it is very difficult to fine-tune the system so as to disable crime opportunities while enabling enterprise: the key then becomes setting up an alert system that reduces the time delays in awareness of misconduct and triggering controls. In principle such adjustments are quicker with administrative and civil than with criminal controls, and can reduce the rate of exploitation of tax crime opportunities. However the public’s demands for retribution and for ‘messages’ to wrongdoers cannot be ignored, and in times of economic downturn, these are likely to be stronger as anger and arguments about ‘fairness’ rise in the public sphere. A better long-term collections strategy may be necessary to enhance our present evidence base, with the aim of improve the rationality of this balance between prevention, civil and criminal measures against serious non-compliance. It is hoped that this review has made a useful contribution to clarifying those options and what knowledge is needed to assess them. What is important is the dispassionate analysis of what we know well, know a little, and know barely at all about the input-output-outcome relationships; and to trace the logic of sanctions from awareness of our own enforcement practices to awareness among our target groups for tax interventions.
References


