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Some Realism About Responsive Tax Administration

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I. INTRODUCTION

Ian Ayres and John Braithwaite prominently set forth responsive regulation as an important regulatory theory.[1] According to this theory, regulators should be responsive to regulated parties and to particular contexts to develop innovative regulatory techniques in different situations. Responsive regulation offers regulatory tools and approaches designed to move beyond a one-size-fits all framework and, ideally, gain voluntary compliance by regulated parties.[2]

Scholars have produced a large body of work on the application of responsive regulation to tax administration, or "responsive tax administration." By and large, this work has supported responsive tax administration as "a viable alternative for organizing the administration of the tax system."[3] Responsive tax administration theory has influenced compliance scholars in the United States and related tax compliance research. For example, Dennis Ventry, Leslie Book, Sagit Leviner, and Rachelle Holmes have advocated explicitly for adoption of responsive tax administration in the United States.[4] Numerous

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[1] The seminal work is Ian Ayres & John Braithwaite, Responsive Regulation (1992). For further discussion of responsive regulation, see text accompanying notes 24-60.

[2] For example, Ayres and Braithwaite in their founding work expound on the benign big gun, tripartism, enforced self-regulation, partial-industry intervention, and delegation and participation. Ayres & Braithwaite, note 1.

[3] Valerie Braithwaite, Responsive Regulation and Taxation: Introduction, 29 Law & Pol'y 3, 4 (2007).

[4] Leslie Book, Refund Anticipation Loans and the Tax Gap, 20 Stan. L. & Pol'y Rev. 85, 113 n.166 (2009) (citing the Compliance Assurance Process as a positive example of the government creating a "dynamic of compliance" within the responsive tax administration framework); Rachelle Holmes, Forcing Cooperation: A Strategy for Improving Tax Compliance, 79 U. Cin. L. Rev. 1415, 1419-21, 1435-41 (2011); Sagit Leviner, A New Era of Tax

other tax scholars have supported programs, such as the Compliance Assurance Process (CAP), that fall within a responsive tax administration framework,[5] and have used responsive tax administration as a model for policy analysis.[6]

The IRS has engaged in a revolutionary renovation of large business tax administration in a manner that, in many ways, is consistent with responsive tax administration theory.[7] Fundamentally, the IRS has shifted toward cooperative tax regulation with large business taxpayers. While the Service, in some respects, has long worked with large business taxpayers as part of its compliance enterprise, these collaborations were limited and did not challenge the inherently adversarial relationship between the IRS and taxpayers.[8] The new, self-

Enforcement: From "Big Stick" to Responsive Regulation, 42 U. Mich. J.L. Reform 381, 385-86, 419-24 (2009); Dennis J. Ventry, Jr., Cooperative Tax Regulation, 41 Conn. L. Rev. 431, 438, 465-66 (2008).

[5] See, e.g., Susan Cleary Morse, The How and Why of the New Public Corporation Tax Shelter Compliance Norm, 75 Fordham L. Rev. 961, 1012-13 (2006) (describing CAP as a regulatory model that "deserves continued support"); Alex Raskolnikov, Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement, 109 Colum. L. Rev. 689, 738 (2009) (discussing CAP as an example of one of the rewards for nongamers that the Service could use in his proposed dual enforcement regime); Bret Wells, Voluntary Compliance: "This Return *Might Be* Correct But *Probably* Isn't," 29 Va. Tax. Rev. 645, 679-80 (2010) (examining CAP as a way "to resolve potential uncertainties in a proactive and transparent manner [which is a] desirable policy outcome"); Lisa De Simone, Richard C. Sansing & Jeri K. Seidman, When Are Enhanced Relationship Tax Compliance Programs Mutually Beneficial? (McCombs Research Paper Series No. ACC-07-11, 2011) available at http://ssrn.com/abstract=1954823; see also Paul J. Beck & Petro Lisowsky, Financial Statement Incentives and Benefits of Voluntary Real-Time Tax Audits 36 (2011 Am. Tax'n Ass'n Midyear Meeting: Research-in-Process, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1761343 (suggesting "that the CAP program has the potential to generate tangible financial reporting benefits that might be of interest to financial regulators like the Securities and Exchange Commission"). For the rooting of CAP within the responsive tax administration framework, see, e.g., Ventry, note 4, at 465 n.196.

[6] See, e.g., Steven A. Dean, Tax Deregulation, 86 N.Y.U. L. Rev. 387, 427-30 (2011) (discussing responsive tax administration's ability to increase compliance through micro-compliance spirals).

[7] See, e.g., Ventry, note 4, at 438, 465-66 (arguing that, as part of a responsive regulation program, the IRS "could involve taxpayers and their advisors more directly in regulatory processes," for example through the "pre-filing initiatives, including the Advance Pricing Agreement (APA) Program, the Industry Issue Resolution program, the Pre-Filing Agreement program, and the Compliance Assurance Process (CAP)" as well as through the "streamlined dispute resolution process" offered by the Fast Track Settlement program); see also John Braithwaite, Large Business and the Compliance Model, in Taxing Democracy 177, 194 (Valerie Braithwaite ed., 2003) [hereinafter Taxing Democracy] (discussing, as examples of the Australian Taxation Office's (ATO) adherence to the responsive regulation framework, a movement "from full audit as a more or less standard single compliance product to a suite of audit products: roll-over audits, pre-lodgment audits, last year lodged audits, specific issue audits, loss tracking audits, new legislation/ruling reviews and record retention audits").

[8] See Yehonatan Givati, Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings, 29 Va. Tax Rev. 137, 141, 149-50, 154-69 (2009) (describing existing advance ruling processes and explaining their limited use within an adversarial system); see

declared, IRS "revolution"[9] in large business tax administration is characterized by a more extensive shift in mentality, away from this adversarial approach and toward cooperative compliance partnerships. A number of innovative programs are part of the revolution.[10] The most significant and transformative is CAP, which began as a pilot program for large business taxpayers in 2005. CAP is a real-time compliance review process, whereby large business taxpayers work with the IRS to resolve all tax positions prior to tax return filing.[11] The list of CAP users is becoming a veritable who's who of major corporations. Companies such as General Motors,[12] Pfizer,[13] Wendy's,[14] Prudential,[15] Estee Lauder,[16] J.C. Penny,[17] and Intel[18] have participated in CAP. Their participation represents a major shift in large business tax administration, from an adversarial, post-filing audit system to a collaborative prefiling conversation.[19] Buoyed by this vision, and citing CAP's "popularity," the IRS recently finalized

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also David M. Schizer, Enlisting the Tax Bar, 59 Tax L. Rev. 331, 335 (2006) (describing both the practice in which large corporations provide auditors on-site space for their auditing duties and how this situation could be manipulated to ensure "a successful audit [from the taxpayer's perspective]").

[9] Donald L. Korb, Korb Discusses "Coming Revolution" in Large Corporate Exams (Jan. 24, 2006), 2006 TNT 16-23, Jan. 25, 2006, available in LEXIS, Tax Analysts File (statement of Donald L. Korb, Chief Counsel, IRS) (citing CAP as part of the "coming revolution in examination of large corporate taxpayers"); Dustin Stamper, Everson Credits Enforcement for New Revenues, Pledges More Reporting Proposals (Oct. 24, 2006), 2006 TNT 205-1, Oct. 24, 2006, available in LEXIS, Tax Analysts File (reporting that IRS Commissioner Mark Everson expects new methods to "revolutionize tax administration").

[10] These programs include, most notably: CAP, APAs (which are, to some extent, carryovers from the old regime), Pre-Filing Agreements, Fast Track Settlement, Limited Issue Focus Examinations, and Industry Issue Resolution. IRS, Large & Midsize Bus. Subgroup Report (2008 IRSAC Report), available at http://www.irs.gov/Tax-Professionals/Large-&-Midsize-Business-Subgroup-Report-(2008-IRSAC-Report).

[11] IRM 4.51.8.

[12] Gen. Motors Co., Annual Report (Form 10-K), at 240 (Apr. 7, 2010), available at http://www.sec.gov./Archives/edgar/data/1467858/000119312510078119/d10k.htm.

[13] Pfizer Inc., Annual Report (Form 10-Q), at 60 (Nov. 5, 2009), available at http://www.sec.gov./Archives/edgar/data/78003/000115752309007794/a6090863.htm.

[14] Wendy's/Arby's Grp., Inc., Annual Report (Form 10-K), at 58, 104 (Mar. 3, 2011), available at http://www.sec.gov./Archives/edgar/data/30697/000003069711000019/form10-k_01022011.htm.

[15] Prudential Fin., Inc., Annual Report (Form 10-K), at 91, 325 (Feb. 27, 2009), available at http://www.sec.gov/Archives/edgar/data/1137774/000119312509039316/d10k.htm.

[16] Estee Lauder, Annual Report (Form 10-K), at F-23 (Aug. 22, 2011), available at http://www.sec.gov/Archives/edgar/data/1001250/000110465911048120/a11-17991_110k.htm.

[17] Jeremiah Coder, Corporate Taxpayers Face Challenges Under New IRS Reporting Regimes (Feb. 17, 2011), 2011 TNT 33-1, Feb. 21, 2011, available in LEXIS, Tax Analysts File.

[18] Id. Many other prominent companies including, in particular, technology companies, have indicated informally their participation in CAP without formally indicating their participation in CAP in SEC filings or otherwise.

[19] Tax Fairness: Policy and Enforcement: Hearing Before the H. Comm. on Appropriations, 110th Cong. (2007) (statement of Kathy Petronchak, Comm'r Small Bus./Self Em-

and expanded CAP.[20] In so doing, IRS Commissioner Douglas Shulman called CAP "a program where the tax system is at its best."[21] He suggested that CAP's finalization would solidify its importance in large business tax administration.[22] The finalization greatly expanded CAP from a program available to only the very largest business taxpayers to one available across the entire large business tax base, which includes approximately 250,000 taxpayers.[23]

Little noticed amidst all the fanfare in support of CAP are the potential problems that lie beneath the surface. This vacuum is emblematic of the broader failure to analyze critically the limitations of responsive tax administration for U.S. tax compliance. This Article contributes to the literature by highlighting this void and beginning to fill it. The Article examines problems with responsive tax administration theory, as well as difficulties with its implementation in the U.S. large business sector. At the theoretical level, responsive tax administration has been treated as increasingly compelling, in the absence of empirical evidence sufficient to support this account. While lack of strong empirical evidence plagues much tax compliance work, the empirical ambiguity in the case of responsive tax administration nonetheless counsels in favor of a more critical analysis. At the implementation level, responsive tax administration programs in the U.S. large business sector have over-emphasized the theory's persuasive aspects, threatening to undermine important deterrence measures (including both the threat of punishment and the threat of random audit).

The Article reaches these conclusions through the case study of CAP, which is a lens into both the theoretical and implementation difficulties. The Article sets forth three central problems with CAP: reduced accountability at the very time that increased accountability is needed, lack of meaningful penalties for failure-to-disclose violations and a resulting "test-drive effect," and a self-selection bias problem. The first problem flows from the potential weaknesses of responsive tax administration theory and the latter two flow from the overemphasis on persuasion in its implementation in the United States.

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ployed Div. of the IRS), reprinted in 2007 TNT 44-27, Mar. 5, 2007, available in LEXIS, Tax Analysts File.

20 Press Release, IRS, IRS Expands and Makes Permanent Its Compliance Assurance Process (CAP) for Large Corporate Taxpayers (Mar. 31, 2011), available at http://www.irs.gov/uac/IRS-Expands-and-Makes-Permanent-Its-Compliance-Assurance-Process-(CAP)-for-Large-Corporate-Taxpayers.

21 Id.

22 Shulman Says IRS Appeals Personnel Will No Longer Sit on Issue Management Teams, Daily Tax Rep. (BNA), Apr. 5, 2011, at G-3.

23 Shamik Trivedi & Amy S. Elliott, LB&I Expands, Makes Permanent CAP Real-Time Audit Program, 131 Tax Notes 10 (Apr. 4, 2011).

The first problem with CAP is that the IRS has linked the rise of CAP with reduced monitoring and accountability for large business tax administration when, in fact, the exact opposite is appropriate. The IRS' faith in CAP to yield compliance is consistent with a measure of academic faith in responsive tax administration more generally. This Article demonstrates that the empirical evidence for responsive tax administration remains complicated and ambiguous, counseling in favor of more caution and less faith in both responsive tax administration and CAP.

The second problem with CAP is that it lacks meaningful penalties for failure-to-disclose violations, which contravenes responsive regulation's own advisement to back up persuasive efforts with a big stick. As a result, CAP lacks an important means to ensure the transparency on which the program is premised. Even more troublesome, CAP creates a test-drive effect, whereby taxpayers are able to see how their IRS review fares, prior to being subject to the failure-to-disclose penalties that apply in the return filing context. The result may be an unfortunate weakening of the important tax disclosure system.

The third problem with CAP is that its expansion beyond the largest taxpayers presents potential self-selection bias problems. While offering CAP to taxpayers that otherwise would undergo a traditional audit may make sense, offering it in a broad-based fashion to taxpayers that otherwise would not be subject to audit may improperly allocate IRS resources. A strain of thought in the tax compliance literature, dovetailing with responsive tax administration theory, suggests that providing service can encourage compliance. Offering CAP by open invitation to all large business taxpayers, however, inappropriately overlooks important research regarding the power of random audit to compel indirect compliance. This is particularly important in a world of scarce resources, in which the IRS simply cannot provide the full responsive tax administration pyramid of persuasion, backed by punitive measures, to all large business taxpayers. Providing service across the entire large business tax base thus overemphasizes persuasion, to the detriment of deterrence.

The Article proceeds as follows. Part II sketches the rise of responsive tax administration, related theories, and CAP, along with claimed benefits of CAP and the limitations of these benefits. Part III examines the problem of reduced accountability as a result of faith in responsive tax administration and CAP. Part IV discusses the lack of meaningful penalties in CAP and the resulting test-drive effect. Part V sets forth the self-selection bias problem. Part VI briefly suggests solutions to each of these problems and explains how the CAP analysis points to a broader need for more realism about responsive tax administration in U.S. large business administration.

II. Rise of Responsive Tax Administration and CAP

Analyzing the influence of responsive tax administration on the U.S. large business sector through CAP requires a basic understanding of the tenets of responsive tax administration, the related lines of tax compliance research, and the development of CAP. Part II provides this framework and also highlights arguments made in favor of CAP and the limitations of these arguments.

A. *Responsive Tax Administration*

Responsive regulation is a strain of thought within a broader, post-New Deal vision of the regulatory state known as "new governance." New governance is a "loosely related family"[24] of governance approaches which, most fundamentally, shift away from a regulatory model known as command-and-control. The command-and-control model, which dominated in the New Deal era and the 1970's, was "hierarchical, state-centric, bureaucratic, top-down and expert-driven."[25] In contrast, new governance "aspires instead to be more open-textured, participatory, bottom-up, consensus-oriented, contextual, flexible, integrative, and pragmatic."[26] New governance rejects both top-down regulation and complete deregulation, attempting to forge a middle ground through cooperative control mechanisms such as negotiated rulemaking, disclosure regimes, and audited self-regulation.[27] A number of academic theories fall under the new governance umbrella, which applies across the governance spectrum, from law promulgation to compliance.[28]

Responsive regulation has been viewed as a particularly powerful strain of thought within new governance theory.[29] Like new governance generally, responsive regulation is not a fixed set of prescriptions for regulating.[30] Rather, responsive regulation has been described as "an attitude that enables the blossoming of a wide variety of regula-

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[24] Bradley C. Karkkainen, "New Governance" in Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping, 89 Minn. L. Rev. 471, 496 (2004).

[25] Id. at 473-74.

[26] Id. at 474.

[27] See Orly Lobel, The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought, 89 Minn. L. Rev. 342, 345, 443 (2004).

[28] See, e.g., id. at 345-47.

[29] See Cynthia Estlund, Regoverning the Workplace 139 (2010).

[30] Ayres & Braithwaite, note 1, at 5.

tory approaches."[31] Central to this theory is the belief that regulated parties have different motivations for acting, and that even the same party may respond to different incentives in different situations.[32] At times, actors may be motivated by economic self-interest; at others they may display a commitment to obey the law. Moreover, an actor's motivation can depend on the regulation employed. As a result, regulation should both respond to and seek to affect the regulated parties.[33]

A central tenet of responsive regulation is that regulators should employ persuasion as a principal, and, indeed, primary means of garnering compliance from regulated parties. As described by Ayers and Braithwaite, "[t]o adopt punishment as a strategy of first choice is unaffordable, unworkable, and counterproductive in undermining the good will of those with a commitment to compliance."[34] Responsive regulation advocates relying on various forms of persuasion to gain compliance. In particular, responsive regulation emphasizes procedural justice as a central means of encouraging voluntary compliance.[35] The procedural justice literature, set forth by Tom Tyler and others, argues procedural justice (including trust, fairness, respect, and neutrality), and not just substantive outcome, has a key impact on perceptions of government and legitimacy, and citizens are more likely to obey the law voluntarily when they perceive an authority as legitimate.[36]

Responsive regulation, however, does not emphasize encouraging compliance only through persuasion and procedural justice. Ayres and Braithwaite have been quite explicit that "[t]o reject punitive regulation is naïve."[37] As a result, punishment is as important as persuasion.[38] Indeed, responsive regulation's most distinctive characteristic is its enforcement pyramid,[39] which provides a concrete path to negotiate between the ideal of appealing to regulated parties' better selves and the possibility of defection. Responsive regulation explains that

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[31] Id.

[32] See, e.g., id. at 4 (noting both that "[g]overnment should . . . be attuned to the differing motivations of regulated actors" and that "[r]egulations themselves can affect . . . motivations of the regulated.").

[33] Id.

[34] Id. at 26.

[35] See, e.g., Valerie Braithwaite, Defiance in Taxation and Governance 51-52 (2009) (noting the influence of procedural justice work on responsive regulation).

[36] Tyler has written extensively about procedural justice. His foundational work, setting forth many of these ideas, is Tom R. Tyler, Why People Obey the Law (1990).

[37] Ayres & Braithwaite, note 1, at 25.

[38] See John Braithwaite, To Punish or Persuade 84-94 (1985).

[39] John Braithwaite, Restorative Justice & Responsive Regulation 30 (2002) (calling the regulatory pyramid "[t]he most distinctive part of responsive regulation").

encouraging compliance through persuasion is both less expensive[40] and more respectful[41] than enforcement.[42] As a result, regulators should first attempt to gain compliance through persuasion, but should respond to lack of compliance by escalating up the pyramid through increasing levels of punitiveness.[43] Responsive regulation assumes that, as a result of both the persuasive appeal and the punitive threat, most regulatory action will occur at the persuasive base of the pyramid, leaving the punitive peak for only the intractable actors.[44]

The responsive regulation architects recognized the inherent dangers of having regulated parties both cooperate and negotiate compliance with regulators, who are imbued with broad discretion. Ayres and Braithwaite acknowledged that both cooperation and discretion "promote the evolution of capture and . . . corruption."[45] They set forth tripartism as a solution. Tripartism means involving appropriate public interest groups at the negotiating table, enabling them to become "credible watchdogs" in the regulatory process.[46] At its best, the "relevant public interest groups . . . become the fully fledged third player in the game" with the capacity to "directly punish the firm."[47]

Responsive regulation has heavily influenced the tax compliance literature, resulting in a body of work addressing responsive tax administration. This theory emphasizes that different taxpayers have different motivational postures, which the regulator must manage to affect taxpayer behavior.[48] As a result, responsive tax administration advocates developing trust in the relationship between tax administrators and taxpayers[49] and offering tax administrators a range of options to respond to compliance issues, rather than just an audit-and-penalty

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40 Ayres & Braithwaite, note 1, at 26.

41 See id. at 25 ("When punishment . . . is in the foreground of regulatory encounters . . . people will find this humiliating, will resent and resist in ways that include abandoning self-regulation.").

42 This insight is also consistent with the procedural justice literature. See Tom Tyler, Trust and Democratic Governance, in Trust & Governance 269, 272 (Valerie Braithwaite & Margaret Levi eds., 1998) [hereinafter Trust & Governance]; Tyler, note 36, at 22-23 (indicating that social control is too costly to be used all the time to ensure that people obey the law).

43 See Ayres & Braithwaite, note 1, at 6, 21-22, 25, 26, 33, 35-36 (1992); John Braithwaite, Institutionalizing Distrust, Enculturating Trust, in Trust & Governance, note 42, at 343, 352; Braithwaite, note 39, at 30-32.

44 Ayres & Braithwaite, note 1, at 35-36.

45 Id. at 55.

46 Id. at 56, 100.

47 Id. at 56.

48 See Valerie Braithwaite, Dancing with Tax Authorities, in Taxing Democracy, note 7, at 15-17.

49 See Kristina Murphy, The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders, 28 Law & Hum. Behav. 187, 188-89 (2004).

model.[50] Responsive tax administration reaches this balance by explicitly incorporating the idea of a regulatory pyramid, for example with education and service at the base, a variety of more interactive compliance programs (such as real-time compliance reviews) in the middle, and audit and punishment at the top.[51]

A number of tax administrations around the globe have explicitly remade themselves under the image of responsive tax administration, providing good examples of relatively complete adoptions of the theory.[52] Australia, in particular, exemplifies explicit adoption of the responsive tax administration theory.[53] Responsive tax administration also impacted other countries, though often in a less explicit fashion. OECD tax compliance materials soon incorporated responsive tax administration theory[54] as did National Taxpayer Advocate reports to the U.S. Congress.[55] Internationally, tax administrators have begun to offer an increasing number of alternative, cooperative compliance

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[50] See Braithwaite, note 7, at 177, 185; Neal Shover, Jenny Job & Anne Carroll, The ATO Compliance Model in Action: A Case Study of Building and Construction, in Taxing Democracy, note 7, at 159, 162.

[51] Braithwaite, note 3, at 3-5.

[52] See Jenny Job & David Honaker, Short-Term Experience with Responsive Regulation in the Australian Taxation Office, in Taxing Democracy, note 7, at 111.

[53] New Zealand and East Timor also explicitly adopted responsive tax administration compliance models. Jenny Job, Andrew Stout & Rachel Smith, Culture Change in Three Taxation Administrations: From Command-and-Control to Responsive Regulation, 29 Law & Pol'y 84, 90-92 (2007). The ATO worked directly with the responsive tax administration architects to remodel the ATO, id. at 90, and adopted a compliance model based on responsive regulation. The compliance model directives were: (1) understanding taxpayer behavior, (2) building partnerships with the community, (3) developing flexibility to encourage and support compliance, and (4) developing a variety of escalating means of enforcing compliance. John Braithwaite, Markets in Vice, Markets in Virtue 71 (2005). The compliance model was an outgrowth of the Cash Economy Taskforce. See Cash Economy Task Force, Austl. Tax'n Office, Improving Tax Compliance in the Cash Economy 18-21 (1997), available at http://www.ato.gov.au/content/downloads/SB39065.pdf; Cash Economy Task Force, Austl. Tax'n Office, Improving Tax Compliance in the Cash Economy 24-26 (1998), available at http://www.ato.gov.au/content/downloads/SB39073.pdf. The ATO developed an interactive training program to inculcate these principles in ATO newcomers as well as seasoned agency officials. Job et al., supra, at 90. It funded the Centre for Tax System Integrity to evaluate the Compliance Model and incorporate public interest, business, and accounting groups into the process as a form of tripartism. Braithwaite, supra, at 71.

[54] Forum on Tax Admin. Compliance Sub-Group, OECD, Compliance Risk Management: Managing and Improving Tax Compliance 70 (2004), available at www.oecd.org/dataoecd/44/19/33818656.pdf.

[55] Marjorie E. Kornhauser, Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers in 2 Nat'l Taxpayer Advocate, 2007 Annual Report to Congress 138, 149-50 (2007), available at http://www.irs.gov/pub/irs-utl/arc_2007_vol_2.pdf (specifically focusing on the importance of procedural justice).

programs for large business taxpayers.[56] These programs are clearly consistent with a move away from a command-and-control regime and toward cooperative compliance partnerships, though they are rarely linked explicitly to responsive tax administration. Recently, the OECD endorsed an "enhanced relationship" model of tax administration, which is rooted in responsive tax administration and is based on the notion that tax agencies and taxpayers should act as partners in the regulatory process.[57]

Countries outside the United States have moved beyond the original vision of responsive tax administration, to incorporate additional strategies, including, most notably, risk management. Australia, for example, incorporated explicit risk management practices into its responsive tax administration regime.[58] Risk management examines both the likelihood that a taxpayer is noncompliant and the relative consequences of the noncompliance, in order to focus resources on taxpayers that present relatively higher risks.[59] After applying this risk management strategy to guide resource allocation, the tax administrator then relies on the compliance pyramid to direct the tax administrator's behavior.[60]

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[56] For extensive description of this international trend and the worldwide programs exemplifying this trend, see Deborah M. Nolan & Frank M. Ng, Tax Dispute Resolution: A New Chapter Emerges, 130 Tax Notes 1053, 1055 (Feb. 28, 2011).

[57] Justin Dabner & Mark Burton, Lessons for Tax Administrators in Adopting the OECD's "Enhanced Relationship" Model—Australia's and New Zealand's Experiences, 63 Bull. for Int'l Tax'n 316, 316 (2009). Prominent former IRS officials (and now practitioners) have characterized CAP as part of this "enhanced relationship" movement. See Nolan & Ng, note 57, at 1058.

[58] See Nolan & Ng, note 56, at 1058-61.

[59] For a good, recent discussion of this risk management strategy, see Stuart Hamilton, New Dimensions in Regulatory Compliance—Building the Bridge to Better Compliance, 10 ejournal Tax Res. 483 (2012). Under this strategy, Australia now applies continuous review for its large corporate taxpayers with both high likelihood of noncompliance and large consequences of noncompliance, continuous monitoring for its large corporate taxpayers with lower likelihood of noncompliance and large consequences of noncompliance, periodic review for its large corporate taxpayers with high likelihood of noncompliance and smaller consequences of noncompliance, and periodic monitoring for its large corporate taxpayers with lower likelihood of noncompliance and smaller consequences of noncompliance. Id. at 501-05.

[60] Id. at 488-93. This Article does not focus in particular on differences between the implementation of responsive tax administration in the United States and in other countries. This issue, which is ripe for examination, is left for another day. For this Article, it is important to recognize that the IRS, in many ways, has drawn from responsive tax administration theory, though its particular implementation has been different than in other countries and is often both less explicit and complete. See Nolan & Ng, note 56, at 1055-56.

B. *Related Theories*

Responsive tax administration's emphasis on persuasive means to gain compliance overlaps significantly with related tax compliance research.[61] Most notably, responsive tax administration is connected to an increasing focus on reciprocity and service to engender compliance. Reciprocity, which has been described as "one of the most potent of the weapons of influence," can be understood, at a basic level as "[t]he rule that says that we should try to repay, in kind, what another person has provided us."[62] The tax compliance literature in recent years has extensively considered how reciprocity can be used to garner compliance from taxpayers.[63] Responsive tax administration proponents have incorporated the principle of reciprocity, explaining that positive behavior by tax authorities will cause taxpayers to reciprocate with strong commitments to tax compliance.[64] Positive behavior, in this context, has been described as "offering cooperation, positive and helpful service, and open dialogue as a first response to conflicts."[65] Relatedly, the general tax compliance literature has emphasized how providing service to taxpayers can elicit greater compliance.[66] Responsive tax administration has also embraced this reasoning, arguing that tax administrators can use service as an important form of persuasion.[67]

[61] See, e.g., Holmes, note 4, at 1420 n.13, 1436 (equating cooperative tax regulation, reciprocity, service, and procedural justice).

[62] Robert B. Cialdini, Influence: The Psychology of Persuasion 17 (2007).

[63] See, e.g., Joshua D. Blank, In Defense of Individual Tax Privacy, 61 Emory L.J. 265, 322-26 (2011) (examining, in part, the impact of privacy on individual tax compliance under taxpayer reciprocity theory); Dan M. Kahan, The Logic of Reciprocity: Trust, Collective Action, and Law, 102 Mich. L. Rev. 71, 81 (2003) (explaining that a taxpayer is "[a]n emotional and moral reciprocator"); Raskolnikov, note 5, at 698-701 (discussing reciprocity as a motivation for taxpaying).

[64] See, e.g., Leviner, note 4, at 415-16.

[65] Id. at 416-17.

[66] See, e.g., Kent W. Smith, Reciprocity and Fairness: Positive Incentives for Tax Compliance, in Why People Pay Taxes: Tax Compliance and Enforcement 223, 227-29 (Joel Slemrod ed., 1992); Peggy A. Hite, A Positive Approach to Taxpayer Compliance, 2 Pub. Fin. 249, 249-51 (1989). Alex Raskolnikov has proposed a comprehensive set of tax regimes to encourage taxpayer compliance. Raskolnikov, note 5, at 713, 754. He suggests that one "regime should emphasize taxpayer service." Id. at 713. As discussed further at note 246, however, Raskolnikov recognizes that service alone is not an appropriate means of separating and targeting taxpayers.

[67] Leviner, note 4, at 415-16.

C. *The CAP Program*

Against this background, the Service reformed the U.S. large business administration[68] (known as the Large Business and International Division (LB&I), and CAP was born. The United States has become a world leader in reforming its large business compliance sector, moving away from a command-and-control model toward an emphasis on cooperation and negotiation.[69] The reformation of large business tax administration, in particular, is especially noteworthy because of the impact that large business tax administration has on revenue. As is widely known, the United States is currently facing a fiscal crisis.[70] Recently, examinations of large corporations generated over 60% of the recommended additional taxes from all IRS examinations.[71] The budget impact of changes resulting from the large business tax administration "revolution," then, is significant as a general matter and especially significant in a fiscal crisis.

[68] Outside of large business tax administration, certain elements of the IRS efforts also seem consistent with responsive tax administration. For example, according to the Service, its mission is to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." IRS, The Agency, its Mission and Statutory Authority, http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority (last visited Sept. 11, 2012). The Service also says that its "role is to help the large majority of compliant taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share." Id. The Service's broader service and enforcement message arose out of the bad press it received in the late 1990's and the subsequent 1998 IRS Restructuring Act. See IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat 685 (codified as amended in scattered sections of the Code). For a good description of these events, see Bryan T. Camp, Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998, 56 Fla. L. Rev. 1, 78-91 (2004). Despite the fact that the Service's dual invocation of service and enforcement appears to be an across-the-board commitment, the IRS has actually most deliberately reformed the large business tax compliance sector. Some have even suggested that the IRS has inequitably focused on reforming large business tax administration based on a service-and-partnership model, to the exclusion of other taxpayers. See, e.g., Christopher Bergin, Working Inside LMSB—A Primer and More, 109 Tax Notes 261 (Oct. 10, 2005) (explaining that the series of new large business initiatives developed by the IRS "did nothing to change my standing conclusion that taxpayers governed by [the large business division] are the Gold Card members under the IRS's business model").

[69] See, e.g., Nolan & Ng, note 56, at 1056 (describing the large number of new U.S. compliance programs, compared to other countries).

[70] See, e.g., Daniel Shaviro, Tax Reform Implications of the Risk of a U.S. Budget Catastrophe, 50 U. Louisville L. Rev. 577, 577-81 (2012).

[71] TIGTA Suggests Improvements to LMSB Currency Initiative (Sept. 26, 2008), 2008 TNT 207-17, Oct. 24 2008, available in LEXIS, Tax Analysts File; see U.S. Gov't Accountability Office, Highlights of the Joint Forum on Tax Compliance: Options for Improvement and Their Budgetary Potential 7 (2008), available at http://www.gao.gov/new.items/d08703sp.pdf (suggesting "focusing more audit resources on the business income tax area . . . [because] very large amounts of money are controlled by some businesses and flow among some of the large businesses and related entities").

The transformation is characterized by an increasing rejection of audits and penalties as the first line of defense against noncompliance. Instead, the IRS is offering an expanding suite of compliance programs. These programs are designed to encourage compliance by offering taxpayers greater service and certainty regarding their tax liabilities. In exchange, they require taxpayers to be more transparent with the IRS, ideally allowing it to better focus its scarce enforcement resources on taxpayers and tax issues meriting greater attention. These programs include Limited Issue Focused Examinations,[72] Fast Track Settlements,[73] APAs,[74] Pre-Filing Agreements,[75] Industry Issue Resolutions,[76] and the Compliance Assurance Process (CAP).[77] Although, the emphasis on flexibility, persuasion, and the move away from an audit-and-penalty model reflect the influence of responsive tax administration theory,[78] the IRS has never explicitly adopted this theory while undergoing this transformation.[79]

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[72] This program provides taxpayers with a streamlined, focused audit process. I.R.M. 4.51.3.1.1 (2007). After undergoing a risk analysis, a taxpayer and the Service enter into a Memorandum of Understanding delineating the limited scope of audit the taxpayer will face, as well as the taxpayer's obligation to cooperate with the Service. I.R.M. 4.51.3 (2007).

[73] This program offers large and mid-size business taxpayers the opportunity to expedite resolution of their tax issues, by having an Appeals official mediate between the taxpayer and Service personnel at an early point in the normal dispute resolution cycle. Rev. Proc. 2003-40, 2003-25 I.R.B. 1044.

[74] APAs are agreements entered into by taxpayers and the Service in order to resolve transfer pricing issues cooperatively, in advance of return filing, rather than in an adversarial, post-return fashion. Rev. Proc. 2008-31, 2008-23 I.R.B. 1133. APAs have existed since the early 1990's. See, e.g., Kristin E. Hickman, Should Advance Pricing Agreements Be Published, 19 Nw. J. Int'l L. & Bus. 171, 177 (1998). As commentators have noted, in large part they arose as a result of the extreme difficulties of policing a very complex transfer pricing regime. Id. at 173. As a result, APAs, by themselves, do not signal a move toward a broad-based, cooperative compliance regime with taxpayers. Nonetheless, because APAs involve advance negotiation with taxpayers regarding tax liability, they are often cited as part of an alternative suite of programs taxpayers can use to reach cooperative resolution with the Service. See, e.g., Nolan & Ng, note 57, at 1053-54.

[75] This program allows taxpayers to resolve, prior to return filing, issues that would likely be disputed in a post-filing audit. Rev. Proc. 2009-14, 2009-3 I.R.B. 324.

[76] Industry Issue Resolutions provides a means for business taxpayers, industry associations, and the like to seek guidance regarding issues that produce uncertainty across a significant number of taxpayers. Rev. Proc. 2003-36, 2003-18 I.R.B. 859.

[77] As described previously, CAP is a cooperative, real-time compliance review, designed to reach certainty as to a taxpayer's tax liability prior to return filing.

[78] See, e.g., Ventry, note 4, at 465-66 (indicating that the Service has "rolled out" a suite of large business tax administration programs that fit within a responsive tax administration framework because they "offer taxpayers and advisors the opportunity to participate directly in the resolution of tax issues," providing "taxpayers and the government increased certainty of outcome as well as lower costs," thereby "discourag[ing] impermissible planning activity by offering tangible incentives for choosing compliance over avoidance").

[79] See Dean, note 6, at 410 n.107.

CAP is the most important of these programs, both because the IRS has indicated that it will become the way of the future for large business tax administration[80] and because it represents the culmination of the Service's embrace of a cooperative model of tax administration. As a result, scholars have rooted CAP in a responsive tax administration framework.[81] Since CAP is the most emblematic and significant example of the influence of responsive tax administration in the United States,[82] analyzing this program is both a useful and important way to begin a critique of the Service's remodeling under the influence of responsive tax administration.

CAP functions as follows: LB&I taxpayers that are either publicly held or agree to submit audited financial statements to the Service on a quarterly basis can apply to be in CAP.[83] The Service decides whether to accept a taxpayer into CAP.[84] Upon entering into CAP, the taxpayer signs a Memorandum of Understanding (MOU), which specifies the parameters for the taxpayer's disclosure of information, establishes disclosure procedures, and indicates the taxpayer's good faith participation.[85] In CAP, taxpayers have to reveal to the Service in real time all material business transactions and other tax issues that arise, as well as the taxpayer's proposed tax positions.[86] The goal is to resolve all tax issues prior to return filing.[87] If the taxpayer and the

[80] See, e.g., Michael Joe, Amy S. Elliott, Jeremiah Coder & Kristen A. Parillo, IRS Responds to Doubts About Uncertain Tax Position Proposal, 127 Tax Notes 243 (Apr. 19, 2010) (indicating that the IRS is working to determine the factors that made CAP successful in order to "expand that success systemwide").

[81] Book, note 4, at 113 (citing to CAP as a positive example of the government creating a "dynamic of compliance" within the responsive tax administration framework); Holmes, note 4, at 1432 (discussing CAP as a "significant cooperation-based initiative" in an article praising responsive tax administration); Ventry, note 4, at 465 (supporting CAP as a way to "break down further [the Service's] adversarial image" in an article articulating a responsive tax administration model).

[82] Other countries around the world have also begun to embrace the CAP model. The Netherlands has adopted a "Horizontal Monitoring" program, whereby business taxpayers agree to full disclosure of all material tax issues in exchange for the Dutch Tax Administration's timely provision of advice. Nolan & Ng, note 56, at 1056-57. In 2009, South Korea began a very similar program in pilot form, called the "Horizontal Compliance Program." Id. at 1056-57. In 2008, Australia launched the "Annual Compliance Arrangement" for select large business taxpayers with sound risk management processes, through which the ATO provides certainty as to low-risk matters in exchange for full disclosure of potential tax issues. Id. at 1058.

[83] Compliance Assurance Process (CAP)—Frequently Asked Questions (FAQs), IRS, http://www.irs.gov/Businesses/Corporations/Compliance-Assurance-Process-(CAP)—-Frequently-Asked-Questions-(FAQs) (last visited Nov. 14, 2012). Additionally, the taxpayer must not be in litigation with the federal government in a way that would materially limit IRS access to the taxpayer's records. Id.

[84] Id.

[85] I.R.M. 4.51.8.5 (2012).

[86] I.R.M. 4.51.8.1 (2012).

[87] Id.

Service cannot reach agreement on all tax issues prior to return filing, then the taxpayer will undergo normal, post-filing examination on the unresolved issues.[88] If the taxpayer meets IRS expectations in CAP, the taxpayer can enter into the compliance maintenance phase, which involves a lower level of IRS review.[89] In this phase, taxpayers must continue making disclosures of material completed business transactions and tax issues.[90] Taxpayers can move in and out of the compliance maintenance phase based on a number of factors, including the complexity of the taxpayer's tax situation.[91] Taxpayers can terminate their involvement in CAP by written request, and the Service can terminate a taxpayer's involvement as a result of failure to abide by the CAP requirements.[92]

CAP's popularity has been steadily increasing.[93] Tax administrators have argued that CAP is the "most significant example of re-engineering the audit process"[94] and a "win-win program" for taxpayers and the IRS.[95] The Service has indicated both that taxpayer satisfaction with CAP is "overwhelmingly high"[96] and that CAP will improve voluntary compliance while cutting audit cycle time.[97] Tax practitioners have repeatedly seconded the IRS claims about CAP's tax administra-

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[88] I.R.M. 4.51.8.7 (2012).

[89] I.R.M. 4.51.8.3 (2012) (indicating that, in the compliance maintenance phase, "the IRS reduces the level of review based on the complexity and number of issues, and the taxpayer's history of compliance, cooperation and transparency in the CAP"); see also Marie Sapirie, IRS Officials Discuss Goals and Impact of Issue Practice Groups, CAP (Nov. 3, 2011), 2011 TNT 214-3, Nov. 4, 2011, available in LEXIS, Tax Analysts File (indicating that the compliance maintenance phase "will involve significantly less scope and depth of reviews on exam").

[90] I.R.M. 4.51.8.6 (2012).

[91] Id.

[92] Id.

[93] IRS News Release IR-2011-32 (Mar. 31, 2011), available at http://www.irs.gov/uac/IRS-Expands-and-Makes-Permanent-Its-Compliance-Assurance-Process-(CAP)-for-Large-Corporate-Taxpayers.

[94] Sheryl Stratton, Cost of Certainty Is Transparency, IRS Says (Apr. 12, 2007), 2007 TNT 72-2, Apr. 13, 2007, available in LEXIS, Tax Analysts File.

[95] IRS News Release IR-2006-94 (June 13, 2006), available at http://www.irs.gov/uac/IRS-Commissioner-Testifies-before-Senate-Committee-on-Finance-on-Compliance-Concerns-Relative-to-Large-and-Mid-Size-Businesses; Hearing on Tax Policy and Enforcement Before the H. Comm. on Appropriations, 110th Cong. (2007) (written testimony of Kathy Petronchak), available at 2007 TNT 44-27, Mar. 6, 2007, available in LEXIS, Tax Analysts File; Shulman Discusses Tax Compliance at ABA Meeting (May 9, 2008), 2008 TNT 92-69, May 12, 2008, available in LEXIS, Tax Analysts File.

[96] Amy S. Elliott, Tiered-Issue Process Will Be Standard in the Future, Says IRS Official (Dec. 10, 2008), 2008 TNT 239-5, Dec. 11, 2008, available in LEXIS, Tax Analysts File.

[97] Heidi Glenn & Warren Rojas, Everson Delays Local EITC Certification Pilot, Supports Other IRSAC Ideas (Nov. 10, 2004), 2004 TNT 219-1, Nov. 12, 2004, available in LEXIS, Tax Analysts File; see also Cliff Jernigan, Corporate Tax Audit Survival 77 (2005) (in which former IRS official states that "CAP should help the Service shorten the time it takes to audit corporate returns, with fewer staff resources, improve overall compliance results, and help identify abusive tax shelter transactions more quickly").

tion benefits.[98] The tax press has noted that CAP has been heralded as "one of the most successful corporate tax enforcement innovations" since the creation of the large business division in 2000.[99] The academic literature has also provided consistent support for CAP.[100] With the program's finalization in 2011 and its shift, at that point, from a program by invitation only to a program open to all LB&I taxpayers, it is poised to expand in the large business taxpayer base. Indeed, the Service's announcement that it had finalized and opened the program to application was acclaimed by taxpayers for meeting the "pent-up demand to get into the program."[101] The Service has indicated both that it "expects to see a growth spurt" in the program,[102] and that it hopes to "expand [on CAP's] success systemwide."[103]

D. *Claimed Benefits of CAP and Limitations of Benefits*

The IRS, practitioners, and tax compliance scholars have offered several reasons to celebrate this expansion. As this Section explains, however, the essentially universal praise for CAP leaves many questions unanswered. The Service has indicated that CAP reduces the use of time and resources to resolve tax issues,[104] allows the IRS to focus its resources on problematic areas,[105] and helps taxpayers by minimizing the uncertainty they face for the purposes of their financial statements.[106] Practitioners second many of these benefits and emphasize that, particularly in the compliance maintenance phase, the

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[98] See, e.g., Trivedi & Elliott, note 23, at 12 (describing the consistent support of practitioners for CAP and their characterizations of the tax administration benefits of CAP, including that it can streamline and reduce expenditures on large case audits); see also Testimony of Kenneth W. Gideon, Chair, ABA Sect. of Tax'n, Before the IRS Oversight Bd. at its Pub. Stakeholder Meeting, available at 2005 TNT 21-32, Feb. 1, 2005, available in LEXIS, Tax Analysts File ("applaud[ing]" the Service for its "bold new" CAP initiative "as part of its efforts to streamline tax administration").

[99] Amy S. Elliott, Areas of Tension in IRS's CAP Program May Cause Growing Pains (Jan. 19, 2011), 2011 TNT 13-1, Jan. 20, 2011, available in LEXIS, Tax Analysts File.

[100] See notes 4-5.

[101] Trivedi & Elliott, note 23, at 12.

[102] Douglas H. Shulman, IRS Comm'r, Speech Before the Tax Exec. Inst. Mid-Year Meeting (Apr. 4, 2011), in 2011 TNT 65-16, Apr. 4, 2011, available in LEXIS, Tax Analysts File.

[103] See, e.g., Joe et al., note 80, at 249.

[104] Sheryl Stratton, Policy Outlook: Taxpayer Transparency Clear; IRS Transparency Cloudy (Apr. 13, 2007), 2007 TNT 73-1, Apr. 16, 2007, available in LEXIS, Tax Analysts File; Sam Young, LMSB Commissioner Discusses Revisions to Coordinated Issues, Enforcement Program, 2008 TNT 100-5, May 22, 2008, available in LEXIS, Tax Analysts File.

[105] IRS, U.S. Treasury Dep't, Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance 36 (2007), available at http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

[106] Shulman, note 95.

streamlined process will save taxpayer resources.[107] Scholars have noted that real-time audit programs can provide the Service with valuable, current information about compliance issues,[108] that CAP "differ[s] radically from the disclose-and-settle-or-we'll-get-you" approach and may help "sustain strong tax compliance norms."[109] Perhaps most fundamentally, scholars have argued that, as a responsive tax administration program, CAP "discourages impermissible planning activity by offering tangible incentives for choosing compliance over avoidance."[110]

Many of these claimed benefits are indisputably desirable, but are somewhat ancillary to CAP's fundamental paradigm shift. For example, the increased efficiency from examining transactions soon after they are entered into could occur in a traditional audit. Even in traditional audits, the Service could hire more auditors (thereby making audit cycles shorter), it could place a priority on expedited document requests, or it could require extensive documentation and interviews as part of the return filing.[111] Without fundamentally shifting to a cooperative, responsive tax administration program, these approaches could result in both more timely review and more current information for the Service.

For many of the other claimed benefits, however, their value could be outweighed by more substantial costs. For example, reducing the burden that taxpayers face in filing their tax returns and reducing the IRS time and resources used to audit taxpayers are clearly laudable goals. The crucial question is at what cost any resource savings are achieved. In the extreme, if CAP review is so light as to encourage large expenditures on creating tax shelters, taxpayers may actually be wasting more resources than they would have under a system with a

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[107] Trivedi & Elliott, note 23, at 3; Mark A. Weinberger, Global Vice Chairman Tax Serv., Ernst & Young, Address at the Ernst & Young Domestic Tax Conference (June 2008), in 120 Tax Notes 893 (Sept. 1, 2008); Gideon, note 98; Timothy J. McCormally, Exec. Dir., Tax Executives Inst., Statement Before the IRS Oversight Board (Feb. 1, 2005), available at http://www.treasury.gov/irsob/meetings/2-01-05/statement-tei.pdf.

[108] Braithwaite, note 53, at 128; Braithwaite, note 7, at 186.

[109] Morse, note 5, at 1012-13.

[110] Ventry, note 4, at 198; see also Holmes, note 4, at 1420 (positing superiority of a cooperative tax regime).

[111] Indeed, the Service has recently announced a number of mechanisms it intends to use to streamline the audit and appeal process for the largest business taxpayers, which do not require a fundamental shift to a cooperative regime. These include "tweaking the information document request (IDR) process to more fully develop cases in Exam, increasing the use of summonses when taxpayers aren't providing information on a timely basis, and prohibiting Appeals from considering new facts or legal arguments not presented or addressed in an examination." Amy S. Elliott, IRS to Revise Corporate Audit Practices, Focus Savings on International, Midmarket Businesses (Mar. 27, 2012), 2012 TNT 59-1, Mar. 27, 2012, available in LEXIS, Tax Analysts File.

high tax filing burden,[112] simply transferring revenue from the government to taxpayers, at great social cost. On the government side of the ledger, the administrative cost savings in CAP may be more than outweighed by the lost revenue from any increased tax sheltering by taxpayers, which then must be collected elsewhere. This danger is particularly acute during a time of severe budget crisis, in which the government direly needs revenue, but is unlikely to be able to raise it from new sources.[113]

Fundamentally, claims that CAP may reduce taxpayer and IRS resources otherwise spent on audit cannot alone justify CAP. Whether or not CAP makes sense depends centrally on its impact on compliance. And, of course, claims that CAP reduces expenditures on audit should not foreclose efforts to increase CAP's effectiveness.

Along similar lines, while taxpayers and the Service alike praise CAP for providing taxpayers greater certainty regarding their financial reserves,[114] it is not clear whether this certainty produces a net benefit. If taxpayers are simply getting up-front certainty regarding outcomes that otherwise would occur after audit and providing the certainty does not prevent the Service from important audits of other taxpayers, the benefit may be unequivocal. If, however, the process of achieving certainty allows taxpayers to get better results than they otherwise would, thereby encouraging more nefarious tax planning, or if the provision of certainty otherwise interferes with the Service's broader compliance agenda, the benefit very well may not be worth the cost.

At bottom, then, important questions remain: Does CAP increase CAP taxpayers' compliance without unduly burdening the Service's broader commitment to ensure compliance across all taxpayers? More generally, is the United States applying responsive tax administration to large businesses in a manner likely to increase or undermine tax compliance in this crucial taxpaying sphere? The next three Parts examine these questions by highlighting problems with CAP, which are emblematic of both potential weaknesses of responsive tax administration theory and its implementation in the U.S. large business sector.

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112 See note 216. Tax shelters are extremely profitable. As a result, from an economic perspective, large business taxpayers have significant reason to enter into tax shelters even if they have large administrative costs.

113 See, e.g., Shaviro, note 70, at 577-79 (describing urgent need for revenue as well as political system dysfunction making it difficult to raise it).

114 Alison Bennett, TRAC Asserts "Historic Collapse in Audits"; Shott Says Interpretation of Data Is Wrong, Daily Tax Rep. (BNA), Apr. 15, 2008, at 6-10 (in which IRS Large and Mid-Size Business Division (now LB&I) Commissioner Barry Shott stated, regarding CAP, that "we decided corporate America needed to have certainty and we made the decision to go forward").

III. Reduced Accountability

The first problem with CAP is that the IRS has reduced accountability regarding the yield from the its compliance efforts, based in part on faith in cooperative tax regulation to yield compliance. This tracks a more general measure of faith in the tax compliance literature for responsive tax administration's ability to deliver greater compliance. As this Part shows, however, this faith in responsive tax administration currently outpaces the empirical evidence. While the evidence certainly does not conclusively defeat the responsive tax administration project, it also does not compel faith in its predictions. At a theoretical level, then, both responsive tax administration and CAP should be met with greater skepticism than presently exists. In particular, responsive tax administration programs, like CAP, may provide aggressive large business taxpayers with the opportunity to reduce their tax liability inappropriately by manipulating norms of reciprocity, shrouded behind secrecy from public scrutiny. This alternative possibility should receive greater attention.

The Service has repeatedly indicated that CAP will result in reduced data regarding large business tax administration.[115] Part of the reason for this is practical. With traditional audits, auditors collect a certain amount of money from audit. The Service then produces extensive statistics regarding amounts earned from audit.[116] These statistics provide clear indications of the direct revenue raised from particular enforcement activities.[117] With CAP, these sorts of statistics are not available. Since taxpayers and the IRS agree on tax liability prior to the taxpayer filing the tax return, there generally will be no amount collected as a result of audit. Practically, then, the Service cannot produce the same type of statistics with CAP.

However, IRS discussion of the reduced data that will accompany CAP evinces more than just practical constraints. A clear underpinning of the Service's explanation is that stakeholders simply do not need the same level of accountability with CAP, given its transforma-

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[115] See, e.g., Douglas H. Shulman, IRS Comm'r, Speech Before the Tax Exec. Inst. (Oct. 21, 2008), 2008 TNT 205-36, Oct. 21, 2008, available in LEXIS, Tax Analysts File; Shulman, note 102; Bennett, note 114.

[116] This information, along with much more statistical information about tax data, is available through the IRS Statistics of Income program, http://www.irs.gov/uac/Tax-Stats-2/ (last updated Oct. 2, 2012).

[117] Of course, direct revenue raised from audits is only one part of the equation. While the indirect effect of audits is harder to determine, a number of studies have undertaken the task. Recently, Jeffrey Dubin determined that over 90% of the revenue raised from increased audit rates arises from the spillover, or indirect deterrence effect. Jeffrey A. Dubin, Criminal Investigation Enforcement Activities and Taxpayer Noncompliance 20 (2012), available at http://www.irs.gov/pub/irs-soi/04dubin.pdf. See text accompanying notes 256-63 for further discussion of direct versus indirect revenue effects.

tive, compliance powers. For example, IRS Commissioner Douglas Shulman explained that, with CAP, "we have changed the game—there are no adjustments, because we are making sure that the right amount of tax is paid on the front-end to avoid adjustments on the back end."[118] This statement is rooted in Shulman's belief that "[r]elationships and paradigms are shifting [as the Service and taxpayers] break down barriers and open doors."[119] Shulman has indicated that the Service is "retooling its relationships with large corporate taxpayers [in a process of] moving away from protracted trench warfare, which serves neither of us well, to earlier and speedier issue resolution and greater efficiency and certainty."[120] In other words, we have arrived at a new day in large business tax compliance. We need not worry about closely monitoring tax administration outcomes because CAP taxpayers are working with the Service, rather than against it. This belief more generally tracks the optimism in the tax compliance literature regarding responsive tax administration's ability to change tax compliance from a game of catch-me-if-you-can to a sustained commitment to meeting tax obligations with integrity.[121]

This perspective is somewhat puzzling. As a general matter, empirical evidence regarding the impact of responsive tax administration remains limited, notwithstanding its now lengthy operation around the world.[122] Self-surveys designed to measure the impact of procedural justice on taxpayers' beliefs about tax authorities comprise much of the evidence that has been developed about responsive tax administration.[123] While the procedural justice literature theorizes that proce-

[118] See Shulman, note 115.

[119] Douglas H. Shulman, IRS Comm'r, Keynote Speech Before the AICPA Fall Tax Meeting (Oct. 26, 2010), available at http://www.irs.gov/uac/Commissioner-of-Internal-Revenue-Douglas-H.-Shulman's-Keynote-Speech-Before-the-AICPA-Fall-Tax-Meeting.

[120] Id.

[121] See, e.g., Ventry, note 4, at 435-38. In line with the responsive tax administration literature, Ventry concludes that "[i]mproving perceptions of procedural justice among taxpayers and advisors can be especially effective in facilitating compliance with tax laws." Id. at 463.

[122] Neal Shover et al., note 50, at 173-74 (discussing the limited efforts to build data collection capabilities into remaking of the ATO as a vehicle of responsive tax administration). While some responsive tax administration programs, such as Australia's transfer pricing record review project, appear to have shown large returns, the ATO's failure to build in controls to test the actual impact of the program limits the empirical conclusions that can be drawn. See Braithwaite, note 53, at 95. If anything, other countries have been even less systematic in their evaluation, due to the often less explicit acknowledgement of remodeling around responsive tax administration principles.

[123] Valerie Braithwaite recently published a comprehensive study of the impact of responsive tax administration on motivational postures, which she describes as "summary statements of how individuals think about their engagement with regulatory authorities." Braithwaite, note 35, at 101. As Braithwaite describes, the source of data for this study comes from a large series of surveys and questionnaires conducted by the Centre for Tax System Integrity in Australia from 2000 through 2005. Id. at 104-06. Other researchers

dural justice should increase commitment to compliance, which should, presumably, actually increase compliance,[124] few responsive tax administration studies have connected the dots all the way from procedural justice to actual, increased tax compliance. Many of the studies that have found a positive relationship between procedural justice and actual tax compliance have relied on taxpayer self-reports of compliance and have found a weak relationship between the two.[125] While one experiment found some links between informational and interpersonal fairness in taxpayer reminder letters and tax compliance, the results in the experiment were nonetheless mixed.[126] Indeed, the experiment found that combining a letter that both

also relied on this survey methodology to reach conclusions about the relationship between responsive tax administration and beliefs about tax administrators and commitment to taxpaying. See, e.g., Martina Hartner, Silvia Rechberger, Erich Kirchler & Alfred Schabmann, Procedural Fairness and Tax Compliance, 38 Econ. Analysis & Pol'y 137, 141 (2008); Kristina Murphy, Enforcing Tax Compliance: To Punish or Persuade?, 38 Econ. Analysis & Pol'y 113, 119 (2008) [hereinafter Enforcing]; Kristina Murphy, Regulating More Effectively: The Relationship Between Procedural Justice, Legitimacy, and Tax Non-Compliance, 32 J.L. & Soc'y 562, 568-71 (2005) [hereinafter Regulating].

124 This belief is inherent in much of the responsive tax administration literature. See, e.g., Murphy, Regulating, note 123, at 567 (hypothesizing that "a regulatory enforcement strategy that makes use of the principles outlined in procedural justice theory may therefore be more effective in gaining future voluntary compliance than a strategy based purely on deterrence").

125 See, e.g., Hartner et al., note 123, at 148 (finding a significant ($p < 0.001$) relationship between negative attitudes regarding procedural justice of the tax office and tax non-compliance, but not finding that positive attitudes regarding procedural justice of the tax office affect tax compliance); Murphy, Enforcing, note 123, at 124 (noting the "problematic . . . finding that both stigmatization and reintegration explain only a small amount of the variation in compliance behavior"); Murphy, Regulating, note 123, at 577, 582 (finding, in one study, weak relationships between tax evasion behavior and other variables in the study, and, in another study, mixed results, depending on measure of tax evasion used); cf. Smith, note 66, at 227-29 (finding a significant negative relationship in self-reports between procedural justice and perceived acceptability of under-reporting income, but failing to find a significant relationship between procedural justice and actual under-reporting); Ronald G. Worsham, Jr., The Effect of Tax Authority Behavior on Taxpayer Compliance: A Procedural Justice Approach, 18 J. Am. Tax'n Ass'n 19, 19-20 (1996) (employing consistency and accuracy as measures of procedural justice and finding mixed impacts on compliance, depending on whether they were experienced directly or indirectly and depending on means of measurement).

126 Michael Wenzel, Principles of Procedural Fairness in Reminder Letters: A Field-Experiment 15-20 (Ctr. for Tax Sys. Integrity, Working Paper No. 42, 2002) [hereinafter Principles]. The results of a portion of this experiment were published at Michael Wenzel, A Letter from the Tax Office: Compliance Effects of Informational and Interpersonal Justice, 19 Soc. Just. Res. 345, 357 (2006).

exhibited informational justice[127] and pointed out a taxpayer right to informational justice actually reduced compliance for entities.[128]

A more disconcerting finding has been glossed over in the literature. Studies have repeatedly shown evidence that, at least in some situations, procedural justice may perversely decrease taxpayers' commitment to tax compliance. Consistent with the research in this area, many of these studies rely on surveys of taxpayers. In an early such study, Thomas Porcano found that tax evaders tended to have "positive perceptions of procedural justice."[129] In 2002, Michael Wenzel similarly found that, although there was some evidence of a link between procedural justice and increased self-reported compliance in certain situations, procedural justice nonetheless had an "unexpected positive, average effect . . . on underreporting of extra income" as reported by taxpayers.[130] In 2005, Kristina Murphy found through survey evidence a "counter-intuitive" positive relationship between procedural justice and tax evasion.[131] In 2007, Valerie Braithwaite, Kristina Murphy, and Monika Reinhart made the "surprising finding" that when taxpayers perceived procedural justice, dismissiveness (a posture associated with lack of concern for the tax administration and taxpaying obligations) tended to be high.[132] On the other hand, Valerie Braithwaite acknowledged that dismisiveness decreased in Australia in response to a government enforcement crackdown.[133] The bottom line is that the limited empirical information currently is not

[127] "Informational justice refers to the provision of information about procedures and (genuine and sound) explanations for decisions." Michael Wenzel, Principles of Procedural Fairness in Reminder Letters and Awareness of Entitlements: A Prestudy 2 (Austl. Nat'l Univ. and Austl. Taxation Office, Ctr. for Tax Sys. Integrity, Working Paper No. 10, June 2001).

[128] Wenzel, Principles, note 126, at 27.

[129] Thomas M. Porcano, Correlates of Tax Evasion, 9 J. Econ. Psychol. 47, 62 (1988).

[130] Michael Wenzel, The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity, 87 J. Applied Psych. 629, 640 (2002). Wenzel explained, "It is not clear why this effect occurred. Perhaps procedural fairness induced perceptions of benevolence of the tax office that let taxpayers anticipate little punishment for their tax evasion. But then it remains unclear why this was the case for one but not the other forms of tax compliance." Id.

[131] Murphy, Regulating, note 123, at 577 n.50. Murphy dismissed the result as potentially just a statistical anomaly.

[132] Valerie Braithwaite, Kristina Murphy & Monika Reinhart, Taxation Threat, Motivational Postures, and Responsive Regulation, 29 Law & Pol'y 137, 150 (2007). The authors hypothesized that either taxpayers viewed the procedural justice as insincere or they viewed it as a sign of weakness.

[133] Braithwaite, note 35, at 116. The connection between procedural justice and compliance is perhaps even more problematic in the case of large businesses, which are represented by agents. I thank Susan Cleary Morse for raising this point. Indeed, the responsive tax administration research has offered little regarding the impact of procedural justice on large businesses, as opposed to individuals, and the impact of agents in the large business context. See further discussion of this point at note 264.

robust enouth to justify solid faith in responsive tax administration's theoretical, transformative powers.[134] While procedural justice may play an important role in increasing compliance, at present, this possibility remains just that—an uncertain possibility. A counterargument is that we need not worry about CAP compliance because, even if CAP does not have transformative powers as a general matter, taxpayers in CAP are going to be conservative taxpayers. These are taxpayers that simply want to pay the "correct" amount of tax, not play games.[135] If this perspective is correct, then we need not concern ourselves with subversion and reduced compliance through CAP.

There are a number of reasons to doubt the sufficiency of this response. As an initial matter, CAP operates in a sphere of tax compliance that invites game playing.[136] Tax law, particularly in the business context, is riddled with both uncertainties[137] and intentional subsidies[138] that create extensive tax planning opportunities, making the distinction between "correctly" paying taxes and playing games a false dichotomy.[139] For example, is a company paying the "correct"

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[134] Even if the Australian evidence did provide a reasonable level of confidence regarding the compliance powers of responsive tax administration, an important question would exist about its translatability to the United States, where the much greater number of regulatees could pose additional complications in applying the responsive tax administration framework. Since the Australian evidence currently does not compel a reasonable level of confidence regarding the powers of the responsive tax administration framework, this Article does not examine the potential impact of cultural differences. Providing empirical evidence in the United States as a means of developing greater evidence regarding responsive tax administration generally would help examine any differences as applied in the United States, specifically.

[135] See, e.g., Raskolnikov, note 5, at 738 ("Needless to say, only companies that 'want to file [their] tax returns correctly' rather than to minimize their taxes at all costs participate in [CAP]."). Raskolnikov did indicate, however, ways that "gamers" might take advantage of disclosing certain positions in prefiling programs, while hiding others. Id. at 739. Other tax scholars have adopted the view of CAP taxpayers as inherently conservative. See, e.g., Holmes, note 4, at 1453 (explaining that conservative taxpayers will choose CAP whereas aggressive taxpayers will not).

[136] See Doreen McBarnet, The Construction of Compliance and the Challenge for Control: The Limits of Noncompliance Research, in Why People Pay Taxes, note 66, at 333 (noting that compliance "is, itself, a social and legal construct"); Doreen McBarnet, Legitimate Rackets: Tax Evasion, Tax Avoidance, and the Boundaries of Legality, 3 J. Hum. Just. 56, 72 (1992) ("How do enforcers enforce the law when the law has not been breached? How do they use strategies to secure compliance when the literal requirements of law are already being met?").

[137] Leigh Osofsky, The Case Against Strategic Tax Law Uncertainty, 64 Tax L. Rev. 489, 494 (2011).

[138] Any number of subsidies could be described. For example, accelerated depreciation methods allow companies to depreciate property for tax purposes at a faster means than depreciation for economic purposes. See IRC § 167 and the regulations thereunder. Nonrecognition rules allow taxpayers to exchange property while deferring gain for tax purposes. See, e.g., IRC §§ 351, 721.

[139] See, e.g. Amanda M. Grossman & Steven D. Grossman, Measuring Tax Policy Aggressiveness, 134 Tax Notes 1677, 1678 (Mar. 26, 2012) ("The inherent complexity of tax

amount of tax if it engages in extensive, albeit legally permissible, tax planning to locate much of its intellectual property in an offshore tax haven in order to reduce U.S. corporate taxes? Answering this question depends on one's perspective regarding the role of U.S. tax law, business' ability to respond to U.S. taxation, and what constitutes an aggressive or conservative tax position, among other things.[140] In short, claiming that CAP taxpayers simply want to pay the "correct" amount of taxes is not particularly helpful in describing the extent of their taxpaying compliance.

Moreover, at least at this time, it simply is not clear that CAP taxpayers are engaged in less game playing than others. As a result of privacy rules,[141] the IRS has not publicly released the names of CAP participants. Consequently, unless companies choose to release information about their participation on their own accord through publicly filed financial documents,[142] information about their CAP participation is not publicly available. Paul Beck and Petro Lisowsky gained access to the Service's private data regarding CAP participants between the years 2007 and 2009 for an empirical paper regarding CAP.[143] Using this data, they determined that "high prior-period effective tax rates . . . are positively associated with subsequent CAP participation."[144] A company's effective tax rate, very roughly, is a measure of the rate of taxation that the company faces on its income.[145] Relatively low effective tax rates can indicate that the taxpayer is more aggressive about engaging in tax planning designed to

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laws provides companies with ample opportunity to assert that the laws are open to more than one interpretation. That is especially true because companies must navigate their way through tax codes at the federal, state, local, and international levels. When formulating a tax strategy, a company's tax specialists may find more than one interpretation of a tax law viable and, based on those interpretations, choose the position that minimizes the tax liability.")

[140] A large body of scholarship exists regarding these questions. See, e.g., Mihir A. Desai & James R. Hines Jr., Evaluating International Tax Reform, 56 Nat'l Tax J. 487 (2003); Mitchell Kane, Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks, 26 Va. Tax Rev. 53 (2006); Edward D. Kleinbard, Stateless Income, 11 Fla. Tax Rev. 699 (2011); Daniel Shaviro, Why Worldwide Welfare as a Normative Standard in U.S. Tax Policy?, 60 Tax L. Rev. 155 (2007).

[141] IRC § 6103. For further discussion of the privacy rules, see text accompanying notes 267-70

[142] See notes 12-16 for representative releases.

[143] Beck & Lisowsky, note 5, at 18-25.

[144] Id. at 5.

[145] In practice, the number of factors that goes into determining effective tax rates can be very complex. For example, a company's effective tax rate takes into account not only its rate of taxation, but also, to some extent, its level of conservativeness with respect to financial statement reserves for uncertain tax benefits. See text accompanying note 203 for further discussion of this point.

lower tax liability.[146] As a result, Beck and Lisowsky's study, at first glance, seems to bolster arguments that CAP taxpayers are conservative types merely trying to pay the "correct" amount of taxes. The answer, however, is not so clear. During the period of the study, CAP was exclusively available to taxpayers only by IRS invitation. As a result, the fact that CAP companies tended to have relatively high effective tax rates may have reflected the Service's choice, rather than that of taxpayers. Going forward, when CAP participation is open to all large business taxpayers by application, a much different, and more aggressive, profile of CAP taxpayers could emerge.[147]

If CAP were shown to take such aggressive taxpayers and increase their compliance, then their participation in CAP might be a good sign. Given the existing lack of such evidence, however, aggressive taxpayer participation in CAP creates concern about the potential for their using CAP to further reduce their compliance. Indeed, anecdotal evidence seems to suggest both that taxpayers with a history of aggressive tax reduction schemes have some interest in CAP and that the Service, going forward, welcomes their participation in the program. Pfizer, for example, has indicated its participation in CAP in its public, financial documents.[148] Pfizer has been no stranger to aggressive tax planning, garnering press for extensive offshoring of its profits in order to drive down its effective tax rate.[149] Indeed, Pfizer's effective tax rate for 2010 was a mere 11.9% as compared to a statutory rate of 35%.[150] While large multinational companies, like Pfizer, often are expected to have a lower effective tax rate than the statutory rate,[151] Pfizer's effective tax rate also appears to be significantly lower than the aggregate effective tax rate of the largest U.S. companies (of

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146 Joshua D. Blank, What's Wrong with Shaming Corporate Tax Abuse, 62 Tax L. Rev. 539, 570 (2009).

147 Cf. Susan C. Morse, Tax Compliance and Norm Formation Under High-Penalty Regimes, 44 Conn. L. Rev. 675, 686 (2012) (suggesting that "[t]axpayers' self-identification in response to a separation program is at least a quasi-public declaration about their compliance values. And after such a declaration taxpayers will be more likely to internalize such compliance as consistent with their view of themselves and with their desire to demonstrate their good reputation.").

148 Pfizer Inc., note 13, at 60.

149 See, e.g., Jesse Drucker, Exporting Profits Imports U.S. Tax Reductions for Pfizer, Lilly, Oracle, Bloomberg, May 13, 2010, http://www.bloomberg.com/news/2010-05-13/exporting-profits-imports-u-s-tax-reductions-for-pfizer-lilly-oracle.html.

150 Pfizer Inc., Financial Report (Form 10-K, Exhibit 13) (Feb. 28, 2011), at 36. Pfizer explains this low effective tax rate, in part, as a result of a large reduction in reserves. Id.

151 See Reuven S. Avi-Yonah & Yaron Lahav, The Effective Tax Rate of the Largest U.S. and EU Multinationals, 65 Tax L. Rev. 375, 383 (2012). Effective tax rates for the largest multinational companies are generally expected to be lower than statutory rates as a result of both intentional advantages provided by U.S. tax law as well as the often extensive planning opportunities available to these companies.

which Pfizer is one).[152] At the least, this partial picture is not consistent with an image of CAP taxpayers as the least aggressive lot. For its part, the Service has explicitly indicated that even taxpayers that use tax shelters are welcome to participate in CAP.[153] Tax shelters are highly engineered tax transactions designed to reduce taxes in a manner not intended by Congress.[154] They are widely deemed to be abusive and designed to subvert the tax system.[155] The Service's invitation to taxpayers engaged in tax shelters into the program indicates a high water mark for potentially aggressive taxpayer behavior becoming a part of CAP. The Service has lived up to its word on this invitation, as taxpayers have boasted about their participation in CAP even while litigating against the government regarding contentious tax shelter transactions.[156] The resulting, hazy picture of the types of taxpayers participating in CAP undermines the notion that only taxpayers seeking to pay the "correct" amount of tax, whatever that may be, will use CAP. We simply do not have enough information to know who uses CAP and how it is being used.

What makes this situation more problematic is that, regardless of the taxpaying disposition that CAP taxpayers start with, CAP itself creates incentives to leverage a norm of reciprocity over time to the advantage of taxpayers, and without the benefit of public oversight. While the tax compliance literature has extensively considered how reciprocity can be used to garner compliance from taxpayers,[157] it has not considered how taxpayers may use reciprocity to garner concessions from the Service. This underexamined aspect of reciprocity nonetheless has a clear role to play in responsive tax administration relationships, where taxpayers and the Service work closely together, as in CAP. Indeed, in Australia, after the ATO remodeled its tax ad-

[152] See id. at 381 tbl.1. As calculated by Avi-Yonah and Lahav, the 100 largest U.S. companies (which includes Pfizer) had an aggregate effective tax rate of 24% in 2010. However, significantly, Avi-Yonah and Lahav calculate aggregate effective tax rate based on current income tax, rather than current income tax plus changes in deferred tax. Id. at 382. Nonetheless, Pfizer's effective tax rate, as listed in its 10-K, was also substantially lower in 2009 and 2008 than the aggregate effective tax rate calculated by Avi-Yonah and Lahav for those years. For 2008 and 2009, Pfizer indicates its effective tax rate was 17% and 20.3%, whereas Avi-Yonah and Lahav calculate the aggregate effective tax rate as being 56% and 30% for such years, respectively. Pfizer Inc., note 150, at 36; Avi-Yonah & Lahav, note 151, at 381 tbl.1.

[153] Elliott, note 96.

[154] Osofsky, note 137, at 511.

[155] For the foundational work on corporate tax shelters, see Joseph Bankman, The New Market in Corporate Tax Shelters, 83 Tax Notes 1775 (June 21, 1999); see also David A. Weisbach, Ten Truths About Tax Shelters, 55 Tax L. Rev. 215 (2002) (examining the complete disutility of tax shelters).

[156] Lee A. Sheppard, News Analysis: An Ad for the CAP Program (Dec. 15, 2009), 2009 TNT 239-3, Dec. 16, 2009, available in LEXIS, Tax Analysts File.

[157] See text accompanying notes 63-67.

ministration around responsive regulation, auditors reported that it was difficult to take a hard line against taxpayers, feeling that doing so would be like "dobbing in a mate."[158] The concern is that taxpayers would leverage the cooperative ethos of the CAP program to garner advantages unavailable in the traditional audit process, thereby reducing taxpayer compliance in a manner nonetheless sanctioned by the Service.[159] This possibility is especially valuable to large, corporate taxpayers that otherwise would certainly be subject to traditional audit. CAP may allow them to manipulate the program's reciprocity norms to obtain desirable (but arguably inappropriate) results.[160]

While reciprocity may be a persistent (and, some would argue, therefore unobjectionable) feature of many interactions between the Service and taxpayers,[161] the tendency toward Service reciprocity is particularly pernicious in the context of CAP. In CAP, the complete veil of secrecy over negotiated outcomes leaves the Service altogether unobserved by the public, leading to the real possibility of capture. While, even in traditional audits, the public does not have direct access to the negotiation between taxpayers and the IRS, its publication of statistics regarding yields from audit nonetheless serves as a check on the agreements reached. Granted, the public cannot easily evaluate the outcomes of a particular company's audit from the general audit statistics that the IRS publishes regarding large business administration. The fact that particular audits will be included in these general statistics, however, likely serves as a reminder to auditors of the inherent goal of producing revenue from audit. Moreover, at the in-

[158] Job & Honaker, note 52, at 121.

[159] Another example from Australia reveals sophisticated taxpayers' awareness of the power of reciprocity to get advantageous results. Ernst & Young Australia has recently advised taxpayers that they should consider "engaging with the ATO at an early stage" because the "ATO is likely to favourably view taxpayers who commence action with them early on." Craig Jackson, Managing the ATO's perception of You in the New Tax Risk Differentiation Framework World Presentation 10 (2012) (paper prepared for Tax Inst. Managing Tax Audits Meeting, Feb. 23, 2012). Along the same lines, "having an open relationship with the ATO will allow taxpayers to couch the relevant transactions in the best possible light, which in turn may reduce the Commissioner's inclination to review the transaction further." Id. at 22.

[160] Indeed, in response to the Service's recent announcements that it hopes to shift resources away from the largest corporate taxpayers, rumors began to circulate of taxpayers planning to drop out of CAP, because of their belief that they would be "left alone" by the Service outside of the program. Amy S. Elliott, IRS Will Still Audit Large Corporate Taxpayers Despite Resource Shift (Apr. 18, 2012), 2012 TNT 76-1, Apr. 19, 2012, available in LEXIS, Tax Analysts File. For these taxpayers, use of CAP presumably was not simply a means of getting certainty, as is often claimed, but rather a perceived means of getting a better outcome than that available in the traditional audit system.

[161] For example, even in the context of traditional tax audits, large business taxpayers often work with the same auditors for an extensive period of time, leading to the possibility of relationship building and the reciprocity that accompanies such relationships.

ternal level, the generation of the statistics creates a salient means of checking agents' agreements with particular companies to ensure they are not too taxpayer favorable. In contrast, since all tax liabilities are negotiated with taxpayers prior to return filing in CAP, the expectation is that there will be no yield from audit of CAP taxpayers.

Indeed, recent comments by Steven Miller, IRS Deputy Commissioner, Service and Enforcement, highlight how the Service celebrates "no change" in tax liability with CAP taxpayers, in direct contrast with its evaluation method in all other contexts.[162] Regarding a high "no change" rate from CAP taxpayers, Miller advised, "Let's celebrate the no change number. In other areas I am responsible for, a high no change rate means we either failed to select the right taxpayer or we missed or mishandled issues. Here, we applaud the rate—now we need to lessen the burden on both taxpayer and the IRS to get to this result."[163] Miller's comments illustrate how CAP layers on top of an internal assumption that taxpayers are compliant, an external evaluation system that does not second guess this assumption. Essentially, CAP and responsive tax administration take tendencies toward inappropriate regulator concessions that admittedly exist in any close regulator-regulatee relationship and make them more extreme, while also hiding them deeper from public view.[164]

The architects of responsive regulation understood well how government-regulatee partnerships can result in capture and offered tripartism as the solution.[165] Unfortunately, as Ayres and Braithwaite note, large business tax enforcement is the "difficult case" in which it is hard to imagine an appropriate public interest group that could be at the negotiating table as a watchdog.[166] Ayres and Braithwaite attribute this difficulty to the "peculiar" way that tax laws "are brought into existence by the state to serve the needs of the state rather than in response to clamoring from external interests."[167] While not considered by Ayres and Braithwaite, extensive privacy laws regarding taxpayer information also present serious, practical problems with using public interest groups in the tax context.[168]

[162] Steven T. Miller, IRS Deputy Comm'r, Serv. & Enforcement, Remarks Before the Tax Exec. Inst., Mid-Year Conference (Mar. 26, 2012), at 2, available at http://services.taxanalysts.com/taxbase/eps_pdf2012.nsf/DocNoLookup/7336/$FILE/2012-7336-1.pdf.

[163] Id.

[164] Clearly, establishing good working relationships with taxpayers helps tax administration to some extent. The argument here, however, is that CAP and responsive tax administration threaten to swing the pendulum too far toward cooperativeness and reciprocity, without adequate checks and monitoring.

[165] See text accompanying notes 45-47 for a description of tripartism.

[166] Ayres & Braithwaite, note 1, at 59.

[167] Id.

[168] For further discussion of taxpayer privacy, see text accompanying notes 267-68.

Nonetheless, especially because of these difficulties, the need for oversight remains strong. Given the secrecy that shrouds agreements reached with taxpayers, the IRS faces one-sided pressure from taxpayers for greater leniency, inappropriately stacking the deck in the taxpayers' favor. Taxpayers of course have not made any public announcement regarding the Service being too lenient in reaching tax liability negotiations in CAP. When taxpayers believe that the Service has not been lenient enough, however, they are free to, and have, indicated as much.[169] This one-sided press, on top of lack of public insight into the process, creates pressure to settle to the satisfaction of taxpayers, thereby threatening to undermine the integrity of the process.[170] Indeed, claims regarding CAP's success are often framed in terms of its popularity with taxpayers,[171] perpetuating pressure on the IRS and individual CAP agents to keep CAP popular.

Some might say that perhaps this result is not objectionable. Possibly taxpayers cooperating with the IRS, thereby potentially reducing use of Service resources, should be entitled to a slightly better tax deal. The response is simply: perhaps. We do not know whether CAP taxpayers are actually providing enhanced cooperation that would merit a better deal. More generally, we just do not know what is happening in CAP, even as more and more of the large business tax base transitions to the program. As indicated in this Part, neither faith in the transformative powers of responsive tax administration, nor faith in the type of taxpayer using CAP, justifies speculation that the program increases, rather than decreases, compliance. Monitoring and evaluation, both absent at present, remain essential.

IV. Lack of Penalties and the Test-Drive Effect

The next problem with CAP is that the IRS has focused extensively on persuasion and cooperation as a means of garnering taxpayer compliance, overshadowing responsive tax administration's dual emphasis

169 See, e.g., Jeremiah Coder, News Analysis: The Future of the CAP Program, 126 Tax Notes 1458, 1458 (Mar. 22, 2010) (practitioner complaints about the Service exam team "digging into issues that may not be necessary"); Amy S. Elliott, Areas of Tension in IRS's CAP Program May Cause Growing Pains (Jan. 19, 2011), 2011 TNT 13-1, Jan. 20, 2011, available in LEXIS, Tax Analysts File (highlighting taxpayer satisfaction as means of determining success of program and quoting a vice president in charge of a CAP taxpayer complaining about the Service's treatment of particular issues); see also Nolan & Ng, note 57, at 1056 (emphasizing that continuing taxpayer participation in the program is a good measure of CAP's success).

170 In a similar context, Service auditors have complained about how pressure to shorten the time period for case closures of large business audits forced auditors to assess a fraction of the taxes owed, resulting in billions of dollars of lost tax revenue annually. David Cay Johnston, Agents Say Fast Audits Hurt I.R.S., N.Y. Times, Jan. 12, 2007, at C1.

171 See, e.g., Nolan & Ng, note 57, at 1056.

on punitiveness. In particular, CAP lacks meaningful penalties for failure to disclose because of faith in the program's ability to ensure transparency. Responsive regulation, however, counsels that the threat of punishment is necessary to ensure compliance. More troublesome, the lack of meaningful failure-to-disclose penalties creates a test-drive effect. Taxpayers can use CAP as an opportunity to test-drive the Service's ability to detect tax issues. CAP taxpayers can then use the information gleaned to decide whether or not they have to disclose a particular tax issue. This test-drive threatens to undermine general disclosure rules developed in recent years. This Part examines this problem and its consequences.

Outside the CAP context, an elaborate set of disclosure rules applies, along with significant penalties for failure to disclose. These rules have played a crucial role in reducing taxpayers' reliance on the audit lottery to hide questionable tax positions. While business taxpayers likely take into account many different factors when making tax compliance decisions,[172] a key factor affecting tax compliance historically has been the likelihood that the Service will detect a particular position on audit ("the audit lottery"). An entire market of corporate tax shelters developed around the audit lottery,[173] and the same logic applies to less egregious tax planning. In determining whether to undertake tax planning, taxpayers may evaluate not only the merits of a tax issue, but also the likelihood the Service will find it.

The IRS and Treasury have turned in recent years to a system of disclosure requirements and penalties to address this compliance challenge. They put into place a set of regulations aimed at tax shelters, which contain an extensive set of reporting rules. They require every taxpayer participating in a "reportable transaction"[174] to file a disclo-

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[172] See, e.g., Michael Doran, Tax Penalties and Tax Compliance, 46 Harv. J. on Legis. 111, 131-38 (2009).

[173] See, e.g., Bankman, note 155, at 1782, 1784 (discussing importance of the audit lottery in the tax shelter market); Joseph Bankman, The Tax Shelter Battle, in The Crisis in Tax Administration 9, 15 (Henry J. Aaron & Joel Slemrod eds., 2004) (describing difficulty the IRS faces in finding tax shelters); Lawrence Zelenak, Tax Enforcement for Gamers: High Penalties or Strict Disclosure Rules, 109 Colum. L. Rev. Sidebar 55, 56 (2009) (noting that "[t]raditionally, a major attraction of tax shelters (footnote omitted) to gamers was the opportunity to play the audit lottery.").

[174] "Reportable transactions" currently include "listed transactions," "confidential transactions," "transactions with contractual protection," "loss transactions," and "transactions of interest." Reg. § 1.6011-4(b)(1). Listed transactions are transactions that are "the same as or substantially similar to" transactions that the Service has "determined to be a tax avoidance transaction" and has so indicated in the form of public guidance. Reg. § 1.6011-4(b)(2). Confidential transactions are transactions "offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee" of $250,000, in the case of a corporation, or $50,000 in most other cases. Reg. § 1.6011-4(b)(3). Transactions with contractual protection are transactions "for which the taxpayer or a related party . . . has the right to a full or partial refund of fees . . . if all or

sure statement, which must be attached to the taxpayer's tax return and sent to the Office of Tax Shelter Analysis.[175] The disclosure statement must "describe the expected tax treatment and all potential tax benefits expected to result for the transaction" and "identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction . . . ."[176] Failure to report reportable transactions results in penalties.[177] The new, strict liability penalty for understatements attributable to transactions lacking economic substance[178] also encourages disclosure of tax shelters, because the penalty increases from 20% to 40% of the underpayment for undisclosed transactions.[179]

The Service appears to have been vigilant in pursuing these penalties. The Treasury Inspector General for Tax Administration (TIGTA) conducted a study in 2010 regarding the Service's application of one, particular failure-to-disclose penalty, the § 6707A penalty.[180] TIGTA found that the IRS asserted large penalties, even when the penalty exceeded the understated tax liability.[181] Although by far most of these penalties were assessed against small businesses that fell outside of LB&I's jurisdiction,[182] the important point for

part of the intended tax consequences from the transaction are not sustained." Reg. § 1.6011-4(b)(4). Loss transactions are transactions in which the taxpayer claims a loss exceeding certain, specified thresholds. Reg. § 1.6011-4(b)(5). Transactions of interest are transactions that are the "same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a transaction of interest." Reg. § 1.6011-4(b)(6).

[175] Reg. §§ 1.6011-4(d), (e).

[176] Reg. § 1.6011-4(d).

[177] Under § 6707A, failure to disclose a reportable transaction results in a penalty of 75% of the decrease in tax as a result of the transaction, not to exceed $200,000 in the case of listed transactions or $50,000 in the case of other reportable transactions. IRC § 6707A(b). The penalty is limited to $100,000 for listed transactions and $10,000 for other reportable transactions in the case of natural persons. Id. Under § 6662A, understatements of tax attributable to certain undisclosed reportable transactions result in a penalty equal to 30% of the understatement. IRC §§ 6662A(a), (c). Additional, negative consequences also result from failure to disclose reportable transactions, including limitations on interest abatement and an extension of the statute of limitations on assessment. IRC §§ 6404(g), 6501(c)(10).

[178] IRC § 7701(o).

[179] IRC § 6662(i). Additionally, the Code now requires "material advisors with respect to any reportable transaction" to file a disclosure statement with the Service identifying and describing the transaction and any tax benefits that may result from the transaction. IRC § 6111(a). Failure to comply with these requirements results in a penalty of $50,000, or, in the case of listed transactions, the greater of $200,000 or 50% of the gross income derived by the material advisor from the transaction. IRC § 6707(b). Other penalties also apply. See IRC §§ 6112, 6708.

[180] Treasury Inspector Gen. for Tax Admin., Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed (Dec. 10, 2010), http://www.treasury.gov/tigta/auditreports/2011reports/201130004fr.html.

[181] Id.

[182] Id.

LB&I taxpayers was that the Service, at least in the studied period, appeared to be quite willing to assess penalties when taxpayers did not meet the requirements.[183] TIGTA concluded that "[t]he penalty resulted in substantially higher disclosure rates to the IRS, which helped to identify and shut down many abusive transactions."[184]

The Service has recently tried to expand this regime with the promulgation of disclosure rules for uncertain tax positions, under Schedule UTP, which places broad requirements on LB&I taxpayers to reveal their uncertain tax issues.[185] While failure to comply with Schedule UTP currently does not result in a penalty other than potential penalties for failure to comply with filing requirements, the Service has warned that it may develop penalties to respond to significant Schedule UTP noncompliance.[186] As a result, Schedule UTP is another example of the signifiant development of disclosure rules and penalties intended to limit the lure of the audit lottery in the traditional audit regime.

The contrast between this elaborate disclosure regime and CAP is stark. The fundamental premise of CAP is that taxpayers will be transparent with the Service regarding all material issues, in exchange for certainty from the Service.[187] Unlike in the tax return filing context (in which the above described disclosure rules and failure to disclose penalties operate robustly), CAP has no meaningful way to ensure transparency, other than faith in the power of CAP to create it.

As discussed in further detail below (with respect to the test-drive effect), the traditional failure-to-disclose penalties do apply to CAP taxpayers when they ultimately file their tax returns. The prefiling nature of CAP, however, means that these failure-to-disclose penalties are much less meaningful for CAP taxpayers than for non-CAP taxpayers. Moreover, CAP contains no formal penalties of its own either to make up for this deficit or to ensure that CAP taxpayers meet the fundamental transparency expectations on which the program is predicated.

What the Service does obtain from CAP taxpayers is an MOU between the Service and each CAP taxpayer, which ostensibly requires

[183] Id.

[184] Id. But see note 216 for some qualifications regarding the importance of the disclosure rules.

[185] See Instructions for Schedule UTP (2010), available at http://www.irs.gov/pub/newsroom/2010_instructions_for_sch_utp.pdf.

[186] Jeremiah Coder, Year in Review: UTP Reporting Regime Rattles Corporate Tax Community (Dec. 13, 2010), 2011 TNT 1-7, Jan. 3, 2011, available in LEXIS, Tax Analysts File.

[187] See Thomas Jaworski, LMSB Commissioner Sees Benefits to Tiered Enforcement System, Tax Return Technology (Nov. 7, 2007), 2007 TNT 217-5, Nov. 8, 2007, available in LEXIS, Tax Analysts File.

that taxpayers "make open, comprehensive, and contemporaneous disclosures of [their] completed business transactions" and all material items.[188] Material items include any item that would require a reserve for financial statement purposes[189] and any item that meets a materiality dollar threshold established by the taxpayer and Service.[190]

The Service's seemingly strongest lever to ensure transparency is the requirement that the taxpayer disclose any issues that would require a financial statement reserve. CAP taxpayers must submit certified, audited financial statements to the Service on a quarterly basis.[191] FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), governs when and how companies must create reserves for uncertain tax benefits on their financial statements.[192] Under FIN 48, a tax benefit must meet two thresholds in order for a taxpayer to be able to recognize the benefit for financial statement purposes.[193] First, there must be a "more likely than not" chance that the position would be sustained, based on its substantive merits.[194] Second, the taxpayer can only recognize the amount of benefit for which there is a greater than 50% likelihood that the Service and the taxpayer would settle on audit.[195] If a taxpayer took a position on its tax return that does not meet this two-step recognition test, it must place a reserve on its financial statements for the tax benefit. As a result, when taxpayers reveal their financial reserves, they are, at least in theory, revealing valuable information about their questionable tax positions.

Moreover, requiring taxpayers to reveal their potential reserves for financial statement purposes leverages the potency of the financial reporting regime. Audited financial statements require the cooperation of outside auditors, who must approve the company's financial statements, including the reserves for uncertain tax benefits.[196] Public companies face potentially grave consequences for concealing transactions from their auditors, under the Sarbanes-Oxley Act ("SOX").[197] CEOs and CFOs of public companies must certify the company's

[188] Compliance Assurance Process (The CAP), Memorandum of Understanding, http://www.irs.gov/pub/irs-utl/capmou-final.pdf (last visited Sept. 13, 2012), at 2.

[189] Id.

[190] Id. at 3.

[191] I.R.M. 4.51.8.4 (2012).

[192] FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (No. 281-B) (June 2006), at 1.

[193] See id. at 3.

[194] Id. at 2.

[195] Id. at 3.

[196] See Thomas C. Pearson & Gideon Mark, Investigations, Inspections, and Audits in the Post-SOX Environment, 86 Neb. L. Rev. 43, 49-50 (2007) (describing auditor's role).

[197] Pub. L. No. 107-204, 116 Stat. 745 (2002).

quarterly financial reports and face criminal penalties for knowingly or willfully certifying a report that does not fairly present, in all material respects, the financial condition, results, and operations of the company.[198] Additionally, if an external auditor discovers that any information has not been revealed, the auditor may declare that the company has a tax-related "material weakness," resulting in adverse reputational consequences to the company, as well as potentially more severe consequences to the parties involved.[199]

This means of ensuring transparency in CAP is not quite as valuable as might appear at first glance. As an initial matter, the Service requires this information from large business taxpayers in the traditional audit regime. Under Schedule UTP, large business taxpayers already must reveal their financial reserves for uncertain tax positions. As a result, requiring taxpayers to reveal their reserves in CAP does not provide the Service assurance of transparency above and beyond what large business taxpayers may supply outside of CAP. Additionally, CAP is available to private companies, as well as public companies.[200] While the CAP rules require private companies to provide audited financial statements to the Service on a quarterly basis, this requirement is not as meaningful. Most of the SOX provisions apply to public, not private companies.[201] As a result, private companies do not face have the same impetus to interact transparently with their auditors. Financial reserves from these companies, therefore, are less valuable in ensuring transparency. Finally, despite the increasingly conventional wisdom to the contrary,[202] for both private and public companies, audited financial statements are not a transparency panacea. Auditors have significant discretion in determining whether a reserve is required for a questionable tax position. As objective as the FIN 48 standards sound, they ultimately rely on an auditor's opinion

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198 See, e.g., 18 U.S.C. § 1350 (2012).

199 See Morse, note 5, at 978-79, for a good description of the negative consequences flowing from a "material weakness," including, in many cases, loss of employment for the company's tax director.

200 I.R.M. 4.51.8 (2012).

201 Limited exceptions apply. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 802(a), 116 Stat. 745, 801, amended provisions of 18 U.S.C. dealing with securities or commodities fraud, the destruction, falsification, and alteration of auditing documents, bankruptcy materials, and matters subject to a federal investigations, as well as a whistleblower protection provision. 18 U.S.C. §§ 1519, 1520, 1514A, 1348. Title IX, the White-Collar Crime Penalty Enhancement Act of 2002, created two new statutory provisions: (1) a mail fraud attempt and conspiracy provision and (2) the creation of a criminal provision forcing the chief executive officer or the chief financial officer to certify all periodic financial statements. This title also enhanced the criminal provisions of the Employee Retirement Income Security Act of 1974. § 904, 805.

202 See, e.g., Wells, note 5, at 660 (2010) (stating that "the combined effect of the enactment of SOX and the issuance of FIN 48 has brought transparency and rigorous documentation with respect to a company's uncertain tax positions").

regarding the likelihood of any number of complicated tax positions being sustained. Empirical evidence reveals that auditors have exhibited widely divergent reserve practices regarding identical, or nearly identical, tax issues.[203] Requiring CAP companies to reveal financial statement reserves, then, does not serve as a unique, or necessarily successful, means of ensuring transparency as to all material tax issues in CAP.[204]

Significantly, the IRS applies no penalty for failure to meet the particular transparency requirements and expectations in CAP. The only formal downside a company faces is that, if a taxpayer does not abide by the spirit of CAP, the Service can remove the taxpayer from the program.[205] For some taxpayers, this possibility could serve as a significant reason to maintain transparency in CAP. Taxpayers that highly value CAP may fear ejection and therefore provide the Service the required transparency. Even these taxpayers, however, should not greatly fear this outcome. The Service has gone out of its way to indicate that taxpayers with problematic relationships with the Service are "just still taxpayers" that could very well be eligible for participation in CAP in the future.[206] An ejected company, then, potentially could mend its ways, or at least appear to do so, and regain entry into the program. For taxpayers that are in CAP simply to try to get a better outcome through CAP than a traditional audit, being returned to the traditional audit regime with no further penalty is no penalty at all, compared to the alternative of just being in the traditional audit regime. Nonetheless, companies that fail to disclose transparently in CAP may face the more informal sanction of red-flagging themselves for audit in future years, should the Service detect their lack of transparency. As an initial matter, though, the Service would have to find a taxpayer's undisclosed transactions or issues in order for this sanction to apply—never an easy task. This informal sanction is also uncertain, at best. Indeed, Lisa De Simone, Richard Sansing, and Jeri Seidman

[203] See De Simone et al., note 5; see also Amy S. Elliott, Wilkins Describes Uncertain Tax Positions Under New Requirements (Mar. 10, 2010), 2010 TNT 47-1, Mar. 11, 2010, available in LEXIS, Tax Analysts File (in which IRS Chief Counsel Wilkins acknowledged that two identical companies could come to different conclusions regarding reserves for financial statement purposes and that their differing conclusions would not be the Service's business).

[204] See Yuni Yan, Minimizing Potential Privilege Implications Caused by Schedule UTP, 3 Colum. J. Tax L. Tax Matters 17, 19 (2012) (explaining, in discussing Schedule UTP, that taxpayers "will likely try to keep such disclosures as limited and vague as possible" and discussing some strategies for doing so, including "simply claim[ing] that the chance of settling any position that passes the 'more likely than not' test is always more than 50%.").

[205] I.R.M. 4.51.8.7 (2012).

[206] Amy S. Elliott, Tiered Issues, Contentious Audits Not a Bar to CAP Acceptance, Says IRS Official (Apr. 13, 2011), 2011 TNT 71-2, Apr. 13, 2011, available in LEXIS, Tax Analysts File.

collected anecdotal evidence from IRS agents indicating both that CAP firms have been less than transparent and that the Service had not even asked these firms to leave the program, much less flagged them for additional review.[207] The bottom line is that, while taxpayers may have reason to fear some contingent, informal consequences as a result of failure to meet CAP's particular transparency requirement, the program remains particularly weak on formal penalties. While punitive measures need not be in the regulatory foreground to ensure compliance,[208] they play little to no role in ensuring transparency in CAP.

As an initial matter, the lack of any meaningful punitive stick in the background to ensure transparency in the foreground exemplifies U.S. large business tax administration's failure to fully implement responsive regulation. Ayres and Braithwaite repeatedly recognize the importance of punitive measures in the regulatory scheme.[209] Again and again, Ayres and Braithwaite emphasize that regulators must apply penalties for failure to comply.[210] Most vividly, Ayres and Braithwaite describe a dog as a model regulator.[211] A dog's "[f]riendliness can turn to a warning bark, then a more menacing growl," escalating until the threat of a "sudden rush."[212] By contrast, in CAP, the Service has no bark and no bite. As a result, the program is in danger of becoming a "bland invocatio[n] of 'voluntary compliance'" rather than "self-regulation in a system of external and internal accountability," as envisioned by responsive regulation's architects.[213] This weakness, of course, would tend to compound any natural tendencies of responsive tax administration to create inappropriately taxpayer favorable results.

Essentially, CAP threatens to provide large businesses with legitimacy, giving them a stamp of approval regarding their tax compli-

[207] De Simone et al., note 5, at 3. The authors conclude that "even when the taxpayer does not always live up to its pledge to disclose all uncertain tax positions, the program can still reduce total expected tax compliance costs incurred by the taxpayer and the revenue authority." Id. at 5. Their model, in this regard, is discussed further at text accompanying notes 225-26

[208] Braithwaite, note 7, at 198.

[209] Ayres & Braithwaite, note 1, at 37-38.

[210] See, e.g., id. at 26, 33-36, 40, 44, 52-53, 161.

[211] Id. at 44.

[212] Id.

[213] Estlund, note 29, at 142; see also Karkkainen, note 24, at 488-89 ("One of the persistent and pervasive misconceptions about New Governance is that it is wholly reliant on 'soft law' mechanisms, and therefore ultimately dependent on the good intentions and voluntary actions of parties who heretofore have shown little inclination toward acting in the desired directions.").

ance,[214] while failing to actually ensure the transparency necessary to guarantee compliance.[215] The unjustified faith in the program to yield transparency has overshadowed the need for penalties to ensure transparency.

Even more problematic, CAP threatens to undermine the broader failure-to-disclose penalties that operate in the general return filing context. While some tax scholars have reasonably questioned the effectiveness of these disclosure rules as currently administered[216] and have examined other important factors for large business tax planning,[217] the disclosure rules undoubtedly have increased the costs of engaging in questionable tax planning and reporting. As a result, offering taxpayers a way out of the otherwise robust disclosure rules through CAP could have broad, deleterious effects on the tax compliance system.

To be sure, CAP taxpayers are technically still subject to the traditional disclosure rules and failure-to-disclose penalties when they ultimately file their tax returns. However, the prefiling nature of CAP creates a test-drive effect that greatly reduces their potency for CAP taxpayers. Taxpayers can use CAP as a chance to determine what the Service can detect, without the threat of failure-to-disclose penalties. Taxpayers in CAP can comply, or even over-comply, with the Service's information requests, all the while failing to disclose a particular questionable tax position. Companies in CAP can provide the Service

[214] See Cliff Jernigan, Corporate Tax Audit Survival, A View of the IRS Through Corporate Insider Eyes (2005). Jernigan suggests that CAP participation could be used to signal a corporation's high level of compliance. ("Company CEOs will want their companies in the CAP program because it, like the Malcolm Baldrige Award, will signify a company known for its honesty and fair dealing.") Id. at 77.

[215] Gregory Rawlings has claimed that responsive tax administration has produced a similar effect in the context of international tax competition. Gregory Rawlings, Taxes and Transnational Treaties: Responsive Regulation and the Reassertion of Offshore Sovereignty, 29 Law & Pol'y 51, 51-52 (2007).

[216] As an initial matter, tax shelters can manufacture enormous tax losses, resulting in economic gains of hundreds of millions of dollars. See, e.g., Black & Decker Corp. v. United States, 436 F.3d 431 (4th Cir. 2006) (tax shelter in which Black and Decker claimed a $560 million capital loss). The value of not disclosing the transaction and thereby greatly decreasing the likelihood of detection may outweigh the additional couple hundred thousand dollars of potential penalty, should the IRS detect the transaction. See Michael L. Schler, Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach, 55 Tax L. Rev. 325, 357-59 (2007) (discussing weaknesses of disclosure approach). Moreover, companies can engage in "overdisclosure" tactics so as to technically abide by the disclosure rules while still making detection unlikely. See generally Joshua D. Blank, Overcoming Overdisclosure: Toward Tax Shelter Detection, 56 UCLA L. Rev. 1629 (2009).

[217] For example, Susan Cleary Morse has argued that Sarbanes-Oxley (discussed in more detail in text accompanying notes 196-99) has helped foster a new "compliance norm" among large corporations that transcends a simple economic deterrence model. Morse, note 5, at 1012.

voluminous information regarding their tax situations in order to hide questionable issues.[218] Taxpayers can provide even more voluminous records in CAP.[219] As a result, taxpayers may bury the Service with information, and perhaps evade the Service's detection of particular, questionable positions.

While this opportunity also exists in traditional audits, the problem becomes more pernicious in CAP because the program eliminates the downside from engaging in this behavior. CAP taxpayers can wait to see what the Service can find in CAP, without facing failure-to-disclose penalties, because they do not apply until return filing.[220] If the Service does find either an undisclosed tax shelter or questionable issue in CAP, then the taxpayer may (but will not necessarily) be dismissed from the program and returned to the traditional audit regime. At that time, however, the taxpayer can then disclose the issue on its tax return and thereby avoid the failure-to-disclose penalties that otherwise would be applicable. Importantly, if the IRS cannot detect the issue in CAP, then the taxpayer can file its tax return without disclosing the issue, with a fair amount of confidence that the Service cannot find it. The taxpayer therefore may not only evade the failure-to-dis-

[218] Corporate tax returns themselves can run tens of thousands of pages. See, e.g., Press Release, IRS, IRS e-file Moves Forward; Successfully Executes Electronic Filing of Nation's Largest Tax Return, (May 31, 2006), available at http://www.irs.gov/uac/IRS-e-file-Moves-Forward;-Successfully-Executes-Electronic-Filing-of-Nation's-Largest-Tax-Return (describing the electronic filing of General Electric's tax return, which, on paper, would have been approximately 24,000 pages long).

[219] At the least, CAP taxpayers must supply the Service with "[a]n industry overview; [c]urrent organizational charts reflecting all related entities and the flow of relevant information involving those entities; [f]inancial performance information; [i]nformation on any anticipated significant events that will affect the reporting for the tax year; and [n]ecessary resources for disclosure of requested information" in addition to "tax schedules and computations for all rollover and recurring adjustments from any previously examined and closed tax period(s) that impact the CAP year return, including the impact of any closing agreements or Appeals settlements," "notice and documentation of any subsequent resolution(s) of items or issues in prior exam cycles within 15 business days of the agreed determination(s)" and responses to any Service information document requests. I.R.M. 4.51.8 (2012).

[220] In another context, researchers have developed evidence regarding the value to taxpayers of being able to see what the tax agency can see. Norman Gemmell and Marisa Ratto examined the impact of audits on U.K. taxpayers. While they predictably found that taxpayers deemed to be "noncompliant" (as determined by positive yield from audit) increased their subsequent compliance, they importantly found that taxpayers deemed to be "compliant" (as determined by zero yield from audit) reduced their subsequent compliance. This effect was the greatest for the largest business group in their study (which was comprised of medium sized businesses). Part of their explanation for the subsequent reduction in compliance by taxpayers determined to be "compliant" was that these taxpayers gained inside information about the tax agency's detection capacity and therefore adjusted their expectation of detection on audit downward. Norman Gemmell & Marisa Ratto, Behavioral Responses to Taxpayer Audits: Evidence from Random Taxpayer Inquiries, 65 Nat'l Tax J. 33 (2012).

close penalties and the risk of such penalties, but also obtain the taxpayer's desirable tax outcome on a questionable, or even highly unlikely, tax position.

One counterweight to the test-drive effect is that being in CAP means that the taxpayer is voluntarily submitting to a general audit. Indeed, taxpayers face two different considerations when evaluating the likelihood that a particular tax position will be audited. The first is whether the taxpayer will be audited at all. The second is whether, if the Service audits the taxpayer, the Service will audit the particular tax issue in question. As a result, volunteering to be in CAP removes one of the major ways that a taxpayer can evade detection on a particular issue, avoiding audit review entirely.

Some taxpayers, however, are all but assured to be audited as a general matter. LB&I is responsible for all business taxpayers with assets greater than $10 million.[221] Within LB&I, there are two categories of cases: Coordinated Industry Cases (CIC) and Industry Cases (IC). A number of factors determine which taxpayers fall into which category, including the taxpayer's size and the complexity of the taxpayer's tax situation. CIC taxpayers are large, complex taxpayers[222] that are audited on an essentially constant basis.[223] As a result, CIC taxpayers stand to gain from the test-drive effect, and they do not lose something they never had—the possibility of avoiding audit entirely.

Even for IC taxpayers, the test-drive effect may outweigh losing the possibility of avoiding audit entirely. While the probability of general audit goes up if the taxpayer decides to partake in CAP, the likelihood of the failure-to-disclose penalty goes down.[224] Whether an IC taxpayer is better or worse off in CAP, then, depends on the taxpayer's possibility of audit outside of CAP, as compared to the decreased likelihood of failure-to-disclose penalties. This calculus will likely vary between taxpayers. At the least, though, the lack of failure-to-disclose penalties in CAP creates an incentive for CIC taxpayers and some IC

[221] IRS, Large Business and International (LB&I) Division Directory, http://www.irs.gov/Businesses/Large-Business-and-International-(LB&I)-Division-Directory (last visited Oct. 24, 2012).

[222] IRM 4.46.2.5 (2006).

[223] IRM 4.46.2.4 (2009).

[224] There would still be some possibility that the IRS could find the issue on the tax return, even though it did not in the CAP context. If the taxpayer gets enough information in CAP, this possibility should be small. If, however, the taxpayer obtains enough information in CAP to know that the Service is likely to find the issue on the tax return, the taxpayer could still disclose the issue on the tax return without facing a failure-to-disclose penalty. If a taxpayer reports an issue on its return that was not agreed to by the Service in CAP, the Service simply audits the issue in a traditional, post-filing review. IRM 4.51.8 (2012).

taxpayers to subvert the disclosure regime, instead utilizing CAP as a chance to see what the Service can see.

As a counterargument, De Simone, Sansing, and Seidman recently have set forth an interesting model regarding enhanced relationship tax compliance programs, like CAP, which questions, to some extent, the need for failure-to-disclose penalties in the context of CAP. They conclude that "a cooperative approach to resolving uncertain tax positions can be beneficial even if neither party can be punished for violating agreed upon terms of an enhanced relationship program."[225] The underlying mechanism in their model is as follows: Taxpayers have uncertain tax positions, which are either weak or strong. Without additional guidance, the Service has to audit all uncertain tax positions. Inside CAP, however, the IRS gains knowledge regarding whether positions are weak or strong. According to the model, taxpayers will only disclose strong positions to the Service in CAP. As a result, the Service can avoid auditing the disclosed positions. The Service can focus on auditing only undisclosed positions, which are presumably weak. If the Service's auditing capacity is strong enough, then taxpayers in CAP will only claim strong positions. The process of disclosure in CAP reduces the Service's auditing costs and provides higher yield from audit.[226]

The argument, however, does not eliminate the problem of lack of meaningful penalties for failure to be transparent in CAP. Crucially, the Service needs to be able to find weak positions in order to challenge them. But the Service has indicated that one of its biggest compliance challenges is identifying issues.[227] Challenging weak positions is how the IRS produces the most significant returns. Therefore, taxpayers' disclosure of weak issues remains essential for IRS administration efforts. CAP systematically reduces taxpayers' incentives to disclose weak positions, relative to the traditional compliance regime. Whatever other benefits CAP may provide the Service, this systematic weakening of taxpayers' incentives to disclose weak positions poses a potentially significant problem for tax compliance, both inside and outside of the program.

[225] De Simone et al., note 5, at 5.

[226] Id.

[227] For example, in connection with the issuance of Schedule UTP, IRS Commissioner Douglas Shulman stated that "today [the IRS] spend[s] up to 25 percent of [its] time in a large corporate audit searching for issues rather than having a straightforward discussion with the taxpayer about the issues. It would add efficiency to the process if [the IRS] had access to more complete information earlier in the process regarding the nature and materiality of a taxpayer's uncertain tax positions." Douglas H. Shulman, IRS Comm'r, Remarks to N.Y. St. Bar Ass'n Tax'n Sec. (Jan. 26, 2010), available at http://www.irs.gov/uac/Prepared-Remarks-of-IRS-Commissioner-Doug-Shulman-to-New-York-State-Bar-Association-Taxation-Section-Annual-Meeting-in-New-York-City,-Jan.-26,-2010.

V. Self-Selection Bias

The final problem with CAP is that it creates the potential for self-selection bias. CAP creates self-selection bias by allowing taxpayers within LB&I to elect into IRS review, thereby reducing the availability of audit resources for non-CAP taxpayers. A strain of the tax compliance literature, dovetailing with responsive tax administration, emphasizes that providing taxpayers service (which is simply a particular form of persuasion) may be an important way to induce voluntary compliance. As an initial matter, like the responsive tax administration empirical research generally, the research regarding service provision specifically, currently is indeterminate. More fundamentally, allowing taxpayers to self-select into IRS review through CAP potentially creates a significant dampening effect on the powerful indirect revenue-raising capabilities of random audits. In a world with infinite resources, the IRS could review all large business taxpayers, first through provision of service, backed up with punitive measures for any noncompliant taxpayers. In reality, though, the IRS faces very limited resources, sharply curtailing the total number of large business taxpayers it can review. In this reality, offering service by invitation to all large business taxpayers threatens to undercut the important deterrence measure of random auditing. As a result, self-selection bias serves as another example of how the implementation of responsive tax administration in U.S. large business has overemphasized persuasion, to the detriment of important deterrence measures.

Prior to CAP's finalization in 2011, the Service chose which taxpayers to invite into CAP. Upon finalization of the program, the Service opened the program to all LB&I taxpayers by application.[228] As a result, all CIC and IC taxpayers can now apply to enter CAP. The Service has indicated that taxpayers will have various rights if their application is denied. Specifically, taxpayers denied entry into CAP may appeal the decision to the Deputy Commissioner (Operations) of LB&I.[229] This appeal is meant to provide taxpayers a "fair hearing" on the denial.[230] The Service has intimated that CAP is available to taxpayers open to working with the Service, even if they have previously had a contentious relationship.[231] While the Service is maintaining some gate-keeping role for entry into CAP through the application process, opening CAP to all LB&I taxpayers by application means that allocation of Service resources is now dictated in part by taxpayer decisions. Taxpayers can now flag themselves for IRS review, rather

228 Trivedi & Elliott, note 23, at 11.
229 IRM 4.51.8 (2012).
230 Elliott, note 206.
231 Id.

than the other way around, and, absent some significant reason for denial, taxpayers will have a good chance of entry.

A major argument made in support of CAP is that it will allow the IRS to move resources downstream within LB&I, thereby increasing compliance. Currently, the roughly 700 CIC taxpayers in LB&I are under continuous audit.[232] This means that the approximately 250,000 smaller, IC taxpayers within LB&I experience a much lower likelihood of audit.[233] In 2010, CIC taxpayers, which comprised less than 1% of LB&I,[234] were allocated more than one-half of its audit resources.[235] The theory is that if CAP reduces the audit cycle time for CIC taxpayers, then the Service can use the saved resources to create a greater presence among the IC taxpayers.[236] As expressed by the Large & Mid-Size Business Subgroup of the IRS Advisory Council, CAP should "result in the ability to reallocate resources to audit mid-market taxpayers," and "[r]e-focusing resources to this basically untouched taxpayer base should pay dividends to the IRS by significantly increasing taxpayer compliance."[237]

If CAP does successfully reduce the use of resources for CIC audits without reducing CIC taxpayers' compliance, then using CAP to shift resources downstream to IC taxpayers seems unobjectionable. The claim that CAP requires fewer IRS resources than a traditional audit, while not shown definitively, seems likely to be true.[238] As explained earlier, however, whether CAP actually maintains (or increases) compliance at the CIC level is currently unclear.[239] As a result, it is difficult to evaluate whether CAP effectively channels resources

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232 Id.

233 IRS Advisory Council Public Meeting, Large & Mid-Size Business Subgroup Report 26 (Nov. 17, 2005), available at http://www.irs.gov/pub/irs-utl/2005_irsac_public_meeting.pdf; Elliott, note 206; see also Elliott, note 111 (in which the IRS Deputy Commissioner for Services and Enforcement lamented this state of affairs and suggested that the IRS intends to take action to downstream and reallocate its resources).

234 At the time, LB&I had a slightly different structure and was called the "Large and Mid-Size Business Division" or "LMSB".

235 Pamela Olson, Announcement 2010-9: Can This Marriage Be Saved?, 51 Tax Mgmt. Memorandum 227 (2010).

236 Jeremiah Coder, Global Economy Will Drive LMSB's Future, Maloy Says (Sept. 22, 2010), 2010 TNT 183-1, Sept. 22, 2010, available in LEXIS Tax Analysts File.

237 IRS, note 233, at 26.

238 Sam Young, IRS Refining Corporate Issues Program, Tax Enforcement, 119 Tax Notes 805 (May 26, 2008) (in which then Commissioner of LMSB Victor Ng indicated that LMSB examinations average around fourteen months, whereas CAP takes only around six months). Unanswered questions include: (1) How does the IRS resource use during CAP compare with resource use during a comparable period of time for a traditional audit? (2) How many IRS resources are used to prepare a taxpayer to be eligible for CAP and to what extent do these figures take into account the preparation stages?

239 See Part III.

downstream from the CIC level without reducing compliance of CIC taxpayers.

Even assuming that CAP does reduce resource use at the CIC level without reducing CIC compliance, offering CAP by open application across all LB&I taxpayers (including the large pool of IC taxpayers, as the Service has recently done) is not necessarily the right tax compliance decision. Rather, allowing IC taxpayers to elect into CAP presents a serious self-selection bias problem. The Service faces perpetual limitations on its resources.[240] To the extent that the Service offers taxpayers that would not otherwise be chosen for audit the opportunity to engage in CAP, CAP reduces Service resources otherwise available for audit based on the Service's selection criteria.[241] As a result, if IC taxpayers electing into CAP dominate resources, the Service may lose its ability to target IC taxpayers based on their compliance profiles. The result may be that the Service expends its resources on relatively compliant, conservative taxpayers forgoing revenue collection from auditing more aggressive taxpayers.

While, as discussed in Part III, aggressive taxpayers may elect into CAP for a variety of reasons, conservative taxpayers that are unlikely to be audited may also elect into Service review, via CAP, for a number of reasons. First, these taxpayers may want to lower the reserves they take for financial accounting purposes. They may believe that, by participating in CAP, they can get the Service to agree that they should succeed on tax positions, even though they could not convince their external auditors of the same. As a result, by participating in CAP, they can get an immediate financial statement benefit on a net basis by reducing their reserves. Taxpayers widely cite management of financial reserves as a reason to participate in CAP.[242] While taxpayers often emphasize that they simply want to gain greater accuracy, and not necessarily a reduction, in their financial statement

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[240] See, e.g., Internal Revenue Service FY 2012 Budget Request: Hearing Before the S. Subcomm. on Fin. Serv. & Gen. Gov't Comm. on Appropriations, 112th Cong. (2011) (statement of Nina E. Olson, Nat'l Taxpayer Advocate) (arguing that the IRS needs more resources and discussing tension between resources for enforcement and service), available at 2011 TNT 111-69, June 8, 2011, available in LEXIS, Tax Analysts File.

[241] See, e.g., Dustin Stamper, High-Income Audits Lead Increases in IRS Enforcement Numbers (Nov. 20, 2006), 2006 TNT 224-3, Nov. 21, 2006, available in LEXIS, Tax Analysts File (in which Service Commissioner Mark Everson explained that the dip in large corporation audits was the result of a shift to CAP); U.S. Gov't Accountability Office, Financial Audit, IRS's Fiscal Years 2007 and 2006 Financial Statements 22 (2007), available at http://www.gao.gov/new.items/d08166.pdf (indicating, in Service Management Discussion and Analysis, that CAP was a reason for shortfall in business audit coverage).

[242] See, e.g., KPMG, Potential Benefits, Burdens for Taxpayers Participating in the IRS Compliance Assurance Process (CAP) Program (2011), available at http://www.us.kpmg.com/microsite/taxnewsflash/Corporate/2011/TNFCorpExec11_16.html.

reserves,[243] Beck and Lisowsky have shown that CAP participation significantly reduces financial reserves, as compared to non-CAP firms.[244] Using CAP and reducing reserves, then, seem to go hand in hand, and may serve as a significant motivation for CAP participation.[245] Second, some taxpayers may have such conservative dispositions that they would not take a questionable position for the purposes of a tax return, if not for some reassurance that the Service agreed with the position. These taxpayers may have much to gain, in terms of reduced, actual tax liability, by getting the Service's assistance in examining issues. Whatever the cause of taxpayers electing into CAP, an essential feature of the program is that taxpayers themselves have a heavy hand in deciding how to allocate IRS examination resources. This is a significant shift from the traditional audit process, in which the IRS is the sole decider.[246]

The Service could reverse course should it find its resources inappropriately dominated by IC taxpayers.[247] At least at present, however, the Service does not seem concerned about the inevitable taxpayer allocation of IRS resources as a result of IC taxpayers electing into examination. Just the opposite. As previously indicated, the Service has both celebrated CAP's finalization and expansion across the LB&I taxpayer base and explained that it hopes to "expand [on CAP's] success systemwide."[248] As a result, without a change in the

[243] See, e.g., M. Catherine Cleaveland, Kathryn K. Epps & Cassie F. Bradley, Real-Time Corporate Tax Audits and Their Impact on Financial Reporting, 80 CPA J. 46, 47 (2010).

[244] Beck & Lisowsky, note 5, at 22-26.

[245] Indeed, the Service has intimated that providing taxpayers certainty (which would lower their reserves for financial reporting purposes) was one of the motivations for creating CAP. See Alison Bennett, TRAC Asserts "Historic Collapse in Audits"; Shott Says Interpretation of Data Is Wrong, Daily Tax Rep. (BNA), Apr. 15, 2008, at G-10.

[246] Cf. Raskolnikov, note 5, at 707-10. Raskolnikov's article set forth a novel, and important, tax compliance framework, in which taxpayers would sort themselves into either a compliance regime or a deterrence regime. The compliance regime would be comprised of programs, like CAP, that would provide guidance for taxpayers. The compliance regime would also contain various features (like a pro-government presumption and mandatory arbitration) designed to make the regime undesirable to aggressive taxpayers that are motivated by economic incentives to underpay their tax liability. Raskolnikov's imagined regime, therefore, combines service provision (for example, through CAP) with negative consequences for taking aggressive positions, in a manner that is absent from the current provision of service through CAP.

[247] There is some precedent for the IRS changing its guidance policy based on perceived misallocation of its resources. In Rev. Proc. 2003-48, the Service announced that it would no longer issue letter rulings regarding the business purpose requirement of § 355. The Service indicated that "it can better serve taxpayers by dedicating its resources to increasing the amount of published guidance regarding § 355, including the business purpose requirement, and other legal questions." Rev. Proc. 2003-48, 2003-2 C.B. 86. I thank Joshua Blank for raising this point. Whether the Service has abided by Revenue Procedure 2003-48 is not entirely clear.

[248] See, e.g., Joe et al., note 80, at 246.

IRS mindset, CAP presents a real danger of taxpayer misallocation of IRS resources.

The strongest argument in favor of this reallocation of IRS resources is that service to taxpayers can be an essential means of ensuring their compliance.[249] According to this line of thought, we should applaud, rather than be concerned about, CAP's provision of service to taxpayers, because providing service through CAP may be an important way to ensure an ongoing, normative commitment to tax compliance among large businesses. This belief aligns with responsive tax administration's emphasis on persuasion as a means of ensuring compliance. Service is a specific form of the broader persuasive effort. As a result, responsive tax administration, in addition to tax compliance scholarship outside the responsive tax administration ambit, has emphasized service as part of the menu of persuasion available to encourage compliance.[250]

As an initial matter, however, like the empirical evidence regarding responsive tax administration more generally, the empirical evidence regarding service is decidedly mixed. As a result, it is questionable which, if any, taxpayers are more likely to comply as a result of service provision in CAP. Despite general support for service as part of the responsive tax administration agenda, and the broader support for service in tax compliance literature, little evidence exists to show that service actually improves compliance in a reliable way.[251] In 1998, the Internal Revenue Service Restructuring and Reform Act reformed the IRS to emphasize taxpayer rights and customer service.[252] In 2003, Leandra Lederman engaged in an extensive review of the claim that service increases compliance, in light of the this legislation.[253] Lederman found that "increased service to taxpayers, in an effort to help them fulfill their compliance obligations, does not seem to affect

[249] See, e.g., Hite, note 66, at 250-51, 262; Raskolnikov, note 5, at 713, 706 n.84; Smith, note 66, at 224-25, 227-29.

[250] For example, ATO Commissioner Michael D'Ascenzo emphasized the importance of service in a speech articulating the application of responsive regulation to Australian tax administration: "Responsive regulation works a bit like a pyramid: at the bottom are the bulk of cooperating taxpayers who enjoy a regulatory strategy based on service delivery, assistance, convenience, access, transparency and accountability." Michael D'Ascenzo, Comm'r, Austl. Tax'n Office, Luncheon Briefing to the Comm. for Economic Development in Australia: Building a Better Australia (June 19, 2008), available at http://www.ato.gov.au/onlineservices/content.aspx?menuid=39504&doc=/content/00148892.htm&page=1.

[251] See, e.g., James Alm, Todd Cherry, Michael Jones & Michael McKee, Taxpayer Information Assistance Services and Tax Compliance Behavior, 31 J. Econ. Psychol. 577, 578 (2010) (noting that the actual effect of a service paradigm on tax compliance has not been examined systematically).

[252] Pub. L. No. 105-206, 112 Stat. 685 (1998).

[253] Leandra Lederman, Tax Compliance and the Reformed IRS, 51 U. Kan. L. Rev. 971 (2003).

compliance."[254] Since Lederman's study, the evidence regarding the impact of service on compliance has not changed significantly. A recent experiment regarding the impact of service on taxpayer compliance found that a tax agency's provision of information increased tax compliance.[255] In the experiment, however, the audit rate was both certain and specified to taxpayers at the time that they made their reporting decision,[256] meaning that they did not consider the potentially reduced indirect deterrence that may result from service provision, discussed below.

Importantly, the emphasis on service without consideration of the impact on deterrence fails, again, to recognize the important balancing act between persuasion and deterrence. Specifically, the use of significant resources in CAP based on taxpayer self-selection poses a danger to the indirect effect of IRS enforcement, or random auditing, activity.[257] Ideally, the Service would have sufficient resources to review the tax situations of all large business taxpayers. If responsive tax administration did, indeed, improve compliance and the Service had unlimited resources, it should first engage all large business taxpayers through persuasive measures and follow up if necessary with more enforcement-based activity. The significant limitations on the Service's resources, however, allow it to review the tax situations of only a fraction of all large business taxpayers.[258] In this world with very limited resources, offering CAP by open invitation to all large business taxpayers, including IC taxpayers that otherwise would not be subject to IRS review, threatens the Service's ability to engage in random audit.

This threat to the Service's random audit capability has important implications for indirect revenue raising capabilities. This "indirect effect" of Service activity is the additional tax revenue raised from taxpayers not directly subject to the Service's efforts, whether they are enforcement efforts (such as an audit) or service provision. The most

[254] Id. at 995-96.

[255] Alm et al., note 251, at 583.

[256] Id. at 582.

[257] In this regard, it is interesting to contrast CAP with programs that are more sensitive to the self-selection problem. John Braithwaite acknowledges that "[o]ne criticism of APAs that may have merit is that they divert resources to cooperative corporations and away from corporations that engage in aggressive tax planning." John Braithwaite, Meta Risk Management and Responsive Regulation for Tax System Integrity, 25 Law & Pol'y 1, 13 (2003). He contrasts this with the Australian Transfer Pricing Record Review and Improvement Project, in which "the most aggressive companies who spurn the APA all get a transfer pricing audit, a more intensive intervention than the APA. Hence, there is fidelity to the principle of the compliance model that cooperation must be associated with movement down the enforcement pyramid and combative tax planning with movement up." Id.

[258] See, e.g., Miller, note 162 (estimating that the Service has an approximately 11.9% coverage rate for the "mid-market" large business taxpayers, which are business taxpayers with assets between $10 million and $250 million).

extensive research about the indirect effects from IRS efforts comes from the context of individual taxpayers. This research suggests that the indirect effect of audits is particularly powerful precisely because taxpayers cannot exert extensive control over whether or not they will be audited.

Most notably, Alan Plumley conducted a comprehensive study of panel data over a ten-year period to determine the indirect behavioral impact of enforcement and service on taxpayer voluntary compliance in the context of individuals.[259] Plumley found that "audits have a strong, positive impact on reporting compliance," and that, specifically, the average indirect effect of audits was 11.6 times the size of the direct adjustment proposed by audit.[260] Plumley found mixed results with respect to service provision.[261] The most important result, for the purposes of extrapolation to CAP, was the comparable effectiveness of audits and return preparation efforts. While Plumley found that assisting taxpayers with return preparation provided a more cost-effective way to increase indirect revenue than audits, this finding was attributable to the fact that audits cost $1298 per unit, whereas providing individual taxpayers with tax return preparation assistance was very cheap, costing only $13.74 per unit.[262] A closer look at the data reveals that audits resulted in much greater indirect revenue per unit than assistance in preparation of taxpayer returns. Specifically, audits yielded thirteen times greater marginal indirect revenue than tax return preparation assistance.[263] The important takeaway point is that audits were much, much more costly, but also much, much more effective, in indirectly increasing voluntary compliance than assisting taxpayers with tax return preparation.

Audits presumably had such a powerful indirect compliance impact because, when the number of audits rises, even taxpayers not subject to audit report more out of greater fear of being audited. To the ex-

[259] Alan H. Plumley, The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness (1996), available at http://www.irs.gov/pub/irs-soi/pub1916b.pdf.

[260] Id. at 35.

[261] He found that return preparation efforts for taxpayers did have a significant and positive effect on taxpayer reporting, but that handling taxpayer telephone calls had a weakly significant negative impact on income reporting. Id. at 37.

[262] Id. at 41.

[263] This figure was derived by the author from Plumley's data as follows. The marginal indirect revenue/cost ratio for audits was 54.6. The marginal indirect revenue/cost ratio for taxpayer-prepared returns was 395.9. The cost per unit for audits was $1298. The cost per unit for taxpayer prepared returns was $13.74. Id. at 41. The indirect revenue for audits could therefore be derived from the equation: Indirect Revenue/1298 = 54.6. The solution was 70,870.8. The indirect revenue for taxpayer prepared returns could be derived from the equation: Indirect revenue/13.74 = $395.90. The solution was $5,439.67. 70,870.0/5,439.67 = $13.03.

tent that provision of service decreases the Service's ability to audit, this powerful, indirect deterrent effect decreases. In short, the threat that any taxpayer at any time may be subject to IRS review (which results from the Service's robust use of random auditing), and not just the actual attention that the Service provides to taxpayers, may have a significant compliance impact.

This theoretical point is significant for the large business context.[264] More IC taxpayers participating in CAP may serve as a signal to other, non-CAP, IC taxpayers that they are less likely to receive IRS review. This is particularly troublesome because CAP requires resources akin to, though not the same as, a traditional audit.[265] CAP therefore may reduce significantly the threat of unwanted examination, in a manner more problematic than offering some lower amount of guidance to taxpayers on a case-by-case basis. It appears to do so without the large, countervailing cost savings accompanying service provision in other contexts. An ideal world in which the IRS would be able to offer CAP to all large business taxpayers without overshadowing the important role of audit in encouraging compliance does not exist. As a result, by being available to all large business taxpayers, CAP once again overemphasizes responsive tax administration's focus on persuasion, to the detriment of an important deterrence measure, in this case random audits.

VI. CAP Solutions and Broader Lessons

In this Article, I examined three problems with CAP: the decreasing accountability as a result of CAP and the resulting need for monitoring, the lack of meaningful failure to disclose penalties in CAP and the resulting test-drive effect, and the self-selection bias problem and the resulting potential misallocation of resources. This Part suggests solutions to each problem. Since this Article provides a first critical look at CAP, these solutions are both novel and preliminary. In line with the general suggestion that responsive tax administration in the

[264] Of course, translating from the individual taxpayer context to the large business context is not ideal. In the large business context, agents are making decisions on behalf of a large organization. The set of dynamics facing these agents will inherently be somewhat different than the dynamics facing individuals. Much of the responsive tax administration research itself is based on studies with individuals. As a result, simply in response, it seems reasonable to include studies such as Plumley's that also rely on individual taxpayers and that seem to point in the opposite direction. More generally, to the extent that existing research (such as Plumley's) raises questions about the direction of the Service's large business compliance efforts, we should take this research into account, albeit with the acknowledgment that future research regarding large businesses specifically is needed.

[265] See note 238 for discussion of the estimated time for CAP as opposed to traditional audit and some open questions.

United States should be subject to more monitoring and critical analysis, these solutions should be viewed as first responses to the problems identified and should be continually reexamined, depending on how they are actually working in large business tax compliance. After setting forth proposed solutions to the particular CAP problems, this Part describes how the CAP analysis points toward a more general need to get realistic about responsive tax administration in U.S. large business.

The clear solution to the first problem with CAP, the decreasing accountability and the need for monitoring, is establishing a system of evaluation. Developing a workable form of evaluation, however, is not easy. Moving toward metrics reduces the discretion that can be central to responsive tax administration. Valerie Braithwaite has also argued that, with responsive tax administration, metrics can simply miss the point. She explains: "Trust and respect depend on understanding the position of others, recognizing different viewpoints, and knowing how to respond to them in a way that is accepted as just and fair. Such understanding does not come from compliance records . . . ."[266]

Nonetheless, some middle road must be forged between complete discretion accompanied by complete secrecy, and a process so hampering that it stymies any possibility for successful, cooperative regulation. This middle road can take a number of forms. First, the IRS should generate and release information that would allow a comparison between the relative tax liabilities paid by companies in CAP and the relative tax liabilities paid by companies not in the program. In determining how, exactly, the Service should reveal this information, a natural tension exists between the desire for specificity and the practical difficulties with revealing useful, specific information. As a general matter, the tax information that taxpayers provide to the IRS is confidential, and the Service is not allowed to reveal it publicly.[267] Even revealing the names of taxpayers participating in CAP seemingly runs afoul of this broad confidentiality rule.[268] While a number

266 Braithwaite, note 35, at 49.

267 IRC § 6103.

268 See IRC § 6103(b) (defining the tax information subject to confidentiality very broadly and including "a taxpayer's identity" within the prohibition). Scholars have frequently noted how § 6103 can, at times, make it difficult for the Service to publicize its enforcement efforts. See, e.g., Stephen W. Mazza, Taxpayer Privacy and Tax Compliance, 51 U. Kan. L. Rev. 1065, 1069 (2003) (concluding that "an uncritical focus on taxpayer confidentiality by Government policy makers has limited the IRS's efforts to create publicity campaigns that could result in dramatic improvements in overall levels of income tax compliance."); Morse, note 147, at 717-18. But see Blank, note 63 (supporting privacy policy because it allows the government to release tax enforcement information selectively, thereby affecting taxpayers' perceptions of the Service's enforcement capabilities).

of CAP taxpayers have publicly revealed their participation in the program,[269] many have not. Nevertheless, the Service could provide de-identified data regarding tax liability paid in CAP and outside of CAP.[270] In order to make the data useful, the Service would need to indicate what tax liability was paid, relative to pretax income. While simply indicating the effective tax rates of companies in CAP and outside of CAP seems like an easy way to do this, effective tax rates would not be a particularly useful measure. Even though they are conveniently publicly available for companies filing public financial statements, effective tax rates are a financial accounting measure. As such, they take into account the reserves that a company has on its financial statements for uncertain tax benefits. As a result, CAP companies may have lower effective tax rates because they have lower reserves, not because they have actually paid less tax to the government.[271] Based on the final tax liability that a company pays for a given tax year, however, the Service should be able to provide useful, though currently not publicly available, information. The Service could indicate the total pretax income or loss of CAP participants, even broken down by industry sector and size (on a no-names basis) along with the total tax liability (or credit) for a given year. This would provide a very rough means of comparing outcomes for CAP and non-CAP taxpayers. In order to have some ability to examine the impact of the program on taxpaying, the Service should provide the same data for CAP and non-CAP taxpayers in the sample for the three years prior to the tax year in question.

If the emerging CAP profile appears problematic, the Service should prepare and release redacted information regarding the nature of agreements reached in CAP versus the traditional audit process. The Service releases a plethora of guidance regarding tax decisions it has reached, including, among other things, revenue rulings, letter rulings, field service advice, notices, and general counsel memoranda.[272] Decisions made in CAP should not fall outside the realm of this exten-

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[269] See notes 12-16.

[270] See § 6103(b)(2)(D) (indicating that the IRS may release "data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.").

[271] An interesting, new paper drives this point home. Lisa De Simone, John R. Robinson, and Bridget Stomberg examined the divergent financial reporting practices of firms, with respect to an uncertain tax issue. De Simone et al., note 5. Specifically, they detailed how paper companies treated the exact same tax issue differently for both tax and financial reporting purposes. Some companies claimed a tax benefit for the purposes of their tax returns; others did not. Of those that claimed the benefit for the purposes of their tax returns, some recorded a reserve for financial statement purposes, others did not. The paper provides insight into how, independent of actual tax return aggressiveness, companies' financial reporting practices can impact effective tax rates.

[272] E.g., Kristin E. Hickman, IRB Guidance: The No Man's Land of Tax Code Interpretation, 2009 Mich. St. L. Rev. 239, 240-41. Indeed, the Freedom of Information Act re-

sive guidance process. Rather, the Service should provide guidance from the CAP context to the same extent it provides guidance from outside of the program.[273] The Service should indicate which guidance is from CAP and which is not, for the purposes of monitoring the differences, if any.

Finally, if this CAP information raises, rather than allays, concerns regarding compliance outcomes in the program, the Service should be open to a dialogue with stakeholders about means of instituting third party monitoring more closely into the process. While this result is clearly cumbersome, it should only be reached if the less intrusive forms of monitoring raise serious questions about the potentially deleterious effect of CAP on large business tax administration. Both the empirical questions about the power of responsive tax administration and the real danger of capture require such potential oversight, as a last resort, to ensure that CAP increases taxpayers' voluntary commitment to tax compliance.

The second problem with CAP is the lack of meaningful penalties for failure-to-disclose violations. As a solution to this problem, the Service should apply penalties for failure to be transparent in CAP, thereby appropriately incorporating all aspects of responsive regulation. A failure-to-disclose penalty applied in CAP is not equivalent to a failure-to-disclose penalty in the context of return filing, because the latter imposes a significant element of risk. The taxpayer has only one chance to disclose—at return filing. If the taxpayer does not disclose on the return as required and the Service finds the issue, then the taxpayer must pay the failure-to-disclose penalty. On the other hand, since CAP involves reviewing taxpayers' transactions in real time, it is not possible to require taxpayers to disclose all issues when CAP review begins. Given this limitation, any penalties applied within CAP

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quires the IRS, like other federal agencies, to release a broad array of "records" to the public. Freedom of Information Act, 5 U.S.C. § 552 et seq. (2006).

[273] Those familiar with the debate over whether to release APAs might question how CAP agreements can be released without inappropriately revealing private taxpayer information. A common argument made against APA release was that APAs rely heavily on detailed taxpayer factual information, which is inappropriate to release under a combination of § 6103 and § 6110. Further, since APAs do rely so heavily on the particular facts and circumstances of a given taxpayer's situation, releasing redacted rulings would not actually provide meaningful guidance. See, e.g., Hickman, note 74, at 187-88 (discussing this argument). However, CAP uniquely comprises agreement regarding a whole set of issues across a taxpayer's entire tax return. As a result, while some agreed-on CAP issues may very well be difficult to redact in a manner that provides meaningful guidance, many presumably could be described in a reasonable, redacted fashion. The important point is that CAP should not be entirely immune from the normal guidance process. To the extent that guidance can come out of the CAP process, it should. To the extent that it is not possible to release meaningful guidance while protecting taxpayer confidentiality, the IRS should release the information it can and explain why it is not releasing more information.

would still allow taxpayers to leverage information obtained during the CAP process to determine whether or not to disclose. As a result, as is the case currently, the traditional failure-to-disclose penalties should apply whether a taxpayer used CAP or not. If a taxpayer used CAP, these failure-to-disclose penalties should be multiplier penalties. In other words, if a CAP taxpayer does not disclose an issue on its tax return as was required by the disclosure rules, the taxpayer should have to pay a penalty that is a multiple of the ordinary penalty. This multiplier penalty should be designed to counteract the reduced risk that results from the test-drive effect inherent in CAP.

The intuition behind multiplier penalties comes from deterrence theory dating back at least to Jeremy Bentham.[274] In modern economics, Gary Becker most prominently explored how the probability of detection impacts deterrence and proposed increasing the size of penalties to offset the probability of an actor avoiding detection.[275] In the tax context, scholars have examined a so-called "Bentham-Becker" penalty, under which the optimal penalty for tax noncompliance is the amount of tax underpaid divided by the probability of detection.[276] Under this model, taxpayers pay higher penalties when the likelihood of nondetection of their noncompliance increases.[277] As applied to CAP, multiplier failure-to-disclose penalties for CAP taxpayers ideally should offset the manner in which the test-drive effect otherwise reduces the penalties' potency.

Scholars have pointed out various potential problems with Bentham-Becker penalties.[278] The principal problems are: the ex post un-

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[274] Jeremy Bentham, Theory of Legislation 325-26 (R. Hildreth trans., London, Trübner & Co. 1864).

[275] Gary S. Becker, Crime and Punishment: An Economic Approach, 76 J. Pol. Econ. 169, 193-98 (1968). Multiplier penalties subsequently received extensive attention in the law and economics literature. See, e.g., Robert Cooter & Thomas Ulen, Law and Economics 446-52 (1988) (modeling optimal combinations of severity and certainty of punishment); A. Mitchell Polinsky, An Introduction to Law and Economics 77-78 (2d ed. 1989); A. Mitchell Polinsky & Steven Shavell, Punitive Damages: An Economic Analysis, 111 Harv. L. Rev. 869, 887-96 (1998); Richard A. Posner, Economic Analysis of Law § 7.1, at 241 (5th ed. 1998).

[276] See, e.g., Kyle D. Logue, Optimal Tax Compliance and Penalties When the Law Is Uncertain, 27 Va. Tax Rev. 241, 266-71 (2007).

[277] Id. at 267.

[278] Scholars have raised issued with multiplier penalties outside the tax context. Richard Craswell has examined how the multiplier principle may be sufficient, but not necessary, when the likelihood of punishment (following detection) varies relative to the egregiousness of the offense. Richard Craswell, Deterrence and Damages: The Multiplier Principle and Its Alternatives, 97 Mich. L. Rev. 2185, 2220-23 (1999). This analysis depends fundamentally on the assumption that an actor's behavior creates social harm, which can be reduced via various precautions. As a result, the analysis does not translate easily to the straightforward tax reporting context, in which the underlying payment is not for social harm (which can be reduced through precautions) but rather for a taxpayer's tax reporting obligations (which, ideally, should not be reduceable through precautions).

fairness of imposing very large penalties on only a limited number of taxpayers, underdeterrence of taxpayers to the extent that they do not have enough assets to pay large multiplier penalties, overdeterrence to the extent that taxpayers are risk-averse, and the difficult problem of determining what the likelihood of detection is and therefore how big the multiplier penalty should be.[279]

These theoretical difficulties should not derail the proposed solution of multiplier failure-to-disclose penalties in CAP. As an initial matter, it is important to recognize that the traditional failure-to-disclose penalties are quite low, relative both to large business taxpayers' total assets and the amount of tax potentially saved from engaging in aggressive tax shelter transactions subject to the disclosure rules. For example, failure to report a listed transaction results in arguably the harshest failure-to-disclose penalty, and yet the penalty amount cannot exceed $200,000.[280] On the other hand, large business taxpayers, by definition, have assets greater than $10 million.[281] Tax shelters subject to the disclosure rules can save taxpayers vast amounts in taxes, for example by producing tax losses in excess of half a billion dollars.[282] These dynamics make some of the theoretical objections to tax multiplier penalties relatively insignificant, when thinking about multiplier failure-to-disclose penalties for CAP participants. Even with very large multipliers, CAP taxpayers are very likely to have enough assets to pay the multiplier penalties. Additionally, given how low the traditional failure-to-disclose penalties are relative to the potential tax savings from tax shelters, CAP taxpayers are also unlikely to be overdeterred significantly as a result of risk-aversity, even with large multiplier penalties.[283] Finally, while there may be some unfairness in imposing large multiplier penalties on only the few CAP taxpayers whose undisclosed transactions are actually detected, this unfairness seems less problematic in light of the fact that the failure-to-disclose penalties themselves (and even multiples of them) are quite low relative to the potential tax savings from tax shelters.

The most difficult issue with establishing multiplier failure-to-disclose penalties is the administrative problem of determining how much the test-drive effect reduces a CAP taxpayer's likelihood of detection on transactions subject to the disclosure rules and, therefore,

[279] Logue, note 268, at 268-71, 277-78.

[280] IRC § 6707A(b)(2)(A).

[281] IRS Large Bus. and Int'l Tax Ctr., http://www.irs.gov/Businesses/Large-Business-and-International-Tax-Center (last updated Sept. 10, 2012).

[282] Osofsky, note 137, at 515.

[283] Despite the relatively low penalty rate, compared to the large potential gain from not complying, taxpayers may nonetheless comply for a variety of noneconomic reasons. Id. at 522-23.

what the multiple should be for such a penalty in CAP. In order for the multiplier penalty to counteract exactly the value to taxpayers of the test-drive effect, the multiple would have to take into account the offsetting factors of decreased likelihood of the failure-to-disclose penalties as a result of CAP and the extent to which CAP increased the likelihood of general audit. Neither of these factors can be determined definitively in any given case, much less in the aggregate. These issues likely will not be determinative, though, because political taste for large tax penalties has historically been very low.[284] As a result, the multiple necessary to counteract the value to taxpayers of the test-drive effect is very likely to be greater than the politically feasible option. The multiple therefore should be as high as politically feasible, which is mindful of responsive regulation's teaching that the higher the punitive peak of the pyramid, the more likely that regulatees will comply voluntarily at the base. Absorbing this lesson in CAP is particularly important, because the current lack of punitiveness not only threatens to undermine transparency in CAP specifically, but also threatens to erode the broader, systemwide potency of the disclosure rules, by essentially providing a means to avoid them.

The solution to the self-selection bias problem is the most straightforward. If CAP really does reduce audit cycle time without decreasing compliance, then it should be available to all CIC taxpayers. These taxpayers otherwise undergo continuous audit, and no downside exists in allowing them to elect into the program. The resources can be downstreamed to IC taxpayers. CAP, however, should not be available openly by application to IC taxpayers. Unless and until CAP costs only a very small fraction of the amount of traditional audits, allowing IC taxpayers to self-select into the program poses too great a danger to the indirect effect of audits on voluntary compliance. The Service should retain its traditional control over which IC taxpayers get IRS review through its own audit selection process.

To be sure, taxpayers may respond to these proposed solutions in both anticipated and unanticipated ways. In other words, we should not assume that the analysis will be static. It is impossible to imagine every possible change in taxpayers' behavior in response to these proposed solutions. Some responses, though, can be more easily anticipated. For example, some might argue that providing taxpayers with additional guidance regarding CAP decisions would increase taxpayers' abilities to tax plan and decrease their desire to participate in the program. Rather than participating in CAP to get a favorable decision regarding a particular transaction, the taxpayer could wait until

[284] See, e.g., Logue, note 276, at 291-92 (discussing political difficulties in obtaining very high tax penalties).

favorable guidance is issued from CAP and then try to rely on the decision as precedent during an audit. While certainly a common concern with respect to IRS guidance more generally,[285] ultimately it should not forestall the release of greater guidance from CAP. While it is beyond the scope of this Article to examine the potential issues with secret guidance to large business taxpayers, it is enough to note that there are equity considerations weighing in favor of the public release of favorable guidance that otherwise may be available only to well-connected CAP taxpayers. Moreover, to the extent that inappropriately favorable guidance is being provided in CAP under the veil of privacy, requiring its release may be an important check on the Service's willingness to concede in secret under the influence of reciprocity. As another example, the enactment of multiplier penalties would reduce the perceived benefit to taxpayers of entering into CAP, as compared to the current system. Some might argue that increasing the size of penalties in CAP might crowd out taxpayers' voluntary compliance incentives in the program.[286] Indeed, imposing penalties always creates this risk. While penalties pose the danger of crowding out voluntary compliance incentives, the absence of penalties creates its own set of problems, including potentially discouraging taxpayers from complying for fear of being the only "chumps"[287] voluntarily paying taxes. Even though imposing penalties carries risks, a hard look at the program reveals that CAP needs more punitiveness. Although only time and experimentation will reveal all the unanticipated consequences of the proposed solutions, the lack of complete information should not prevent adopting solutions that appear to be the best course of action, given the existing information. Additionally, greater monitoring of CAP generally, as proposed, should allow continued evaluation of and response to the intended and unintended impacts of these solutions.

Stepping outside the particular CAP problems analyzed and solutions proposed, this Article is a first step in a broader critique of the responsive tax administration model in the U.S. large business tax sphere. To some extent, each responsive tax administration program must be evaluated based on its own, particular application in a given

[285] See Amy S. Elliott, Roundtable Panelists Lament Tax Guidance Process (July 25, 2011), 2011 TNT 142-1, Aug. 1, 2011, available in LEXIS, Tax Analysts File (in which practitioners and the IRS discuss the Service's fear of releasing incorrect guidance that taxpayers might be able to take advantage of).

[286] For a classic example of penalties crowding out intrinsic compliance motivation, see Uri Gneezy & Aldo Rustichini, A Fine Is a Price, 29 J. Leg. Stud. 1, 3 (2000) (describing how imposition of fines for late pickups at daycare increased late pickups).

[287] See, e.g., Blank, note 146, at 542, 580 (discussing how taxpayers may fail to pay taxes if they believe others are not, in order to avoid feeling like "chumps").

tax compliance setting.[288] Responsive regulation, after all, holds as a central tenet the idea of responsiveness. At base, compliance programs should be judged based on whether they work in particular situations.

Nevertheless, the analysis of CAP in this Article provides certain lessons that can be generalized as part of a continuing examination of responsive tax administration in U.S. large business tax compliance. The first lesson is that responsive tax administration, while offering theoretical promise, suffers from potential, underappreciated weaknesses. In an ideal world, responsive tax administration would be able to turn tax-minimizing, game-playing taxpayers into partners engaging in a productive conversation with the government about their tax obligations. At present, this vision is simply an ideal. Taxpayers engaging in any number of programs linked with responsive tax administration, including CAP, the Fast Track Settlement Program, Limited Issue Focus Examinations, the Pre-Filing Agreement Program, and the Industry Issue Resolution Program, have not been shown to be less likely to be engaging in tax-reducing games than other taxpayers. The Service has not produced evidence regarding these programs that provides cause for faith in the integrity of their tax compliance outcomes. The empirical evidence regarding Responsive Tax Administration, generally, in some ways raises additional concerns. As a result, we should be wary of support for compliance programs merely because scholars have linked such programs to a responsive tax administration regime. Along the same lines, we should be wary of claims by government officials that we have reached a new day in large business tax compliance, simply because companies are utilizing programs emphasizing cooperation between taxpayers and tax administrators. While the lack of convincing empirical evidence is not an inherent failing of responsive tax administration, it does counsel against accepting its predictions, without considering alternative, potential impacts that responsive tax administration may have on taxpayer compliance. As the United States continues to develop large business tax compliance programs based in these ideas of cooperative tax regulation, then, it should continually assess the actual impact of responsive tax administration on compliance.[289]

[288] See Valerie Braithwaite, A New Approach to Tax Compliance, in Taxing Democracy, note 7, at 8 (noting that responsive regulation is not a "cookbook[ ]" that can be applied in the same manner in all situations).

[289] See Lobel, note 27, at 450 ("As is often the case in a paradigm transformation, supporters of the nascent vision invest great efforts to demonstrate its potential and strengths, often by imagining the best possible scenarios for the adoption of the new framework. However, ideal theories are never risk free. Particularly in the rich setting of governance, with its affluence in meanings, there is also a need to warn against certain blind spots and

The second lesson is that, even putting aside some of the theoretical difficulties with responsive tax administration, incomplete implementation can exacerbate existing weaknesses. Namely, the implementation of largely persuasive aspects of the program without punitive backing may threaten both the integrity of responsive tax administration programs and the broader large business tax compliance system. This implementation failing may result because a program, like CAP, may gain scholarly support as part of a responsive tax administration framework, without sufficient attention in the regulator community to the entirety (or even the existence, as the case may be) of the theory that influenced the program's creation. The responsive tax administration architects themselves recognized that responsive tax administration does not work absent important punitive elements. Given the real institutional constraints facing regulators, however, these punitive elements may fall by the wayside. Even if, in an ideal world, the IRS could offer ample amounts of persuasive service to all taxpayers without undermining deterrence capabilities, given the reality of resource constraints, a tradeoff exists between the two. Focusing extensively on service therefore poses a threat to the deterrence features that play an important role in the large business tax compliance system.

A number of lessons can be drawn from these implementation difficulties. Even to the extent that we can get comfortable with responsive tax administration's emphasis on persuasion to elicit cooperation from taxpayers (for example, by instituting monitoring and checks to assure that persuasiveness does not give way to inappropriate regulator concessions), we must ensure that, in implementing the program, persuasion remains backed by significant punitive and deterrence-based elements. To the extent that tax administrators do not have sufficient resources to foreground persuasion while maintaining strong punitive and deterrence-based elements, we should strongly consider curtailing the persuasive program. Under such circumstances, responsive tax administration should be implemented creatively, for example, only in sectors in which the IRS has the resources to put the entirety of the program in place. The CIC taxpayer sector is likely such a place. The entire large business tax base likely is not. Particular, targeted compliance projects may present other possibilities for complete application of the program. Alternatively, combining risk

difficulties."); see also Braithwaite, note 39, at 229 (acknowledging the importance of developing hard empirical evidence and indicating that "[i]t will take many years of hard empirical work before we know whether restorative and responsive tax administration can actually increase the integrity of tax systems.").

management with responsive tax administration may offer a more reasonable and fruitful path forward.[290]

At bottom, we must get beyond the promise of responsive tax administration and give a good, hard look into whether responsive tax administration is working as promised in United States large business.

[290] See text accompanying notes 59-60. At this point, although I do not necessarily endorse this possibility, the practice is worth additional examination.