The Popular Tax Audit: Enforcing the Social Value of Taxation

Governments assess taxation as a market transaction: a quantifiable cost of doing business in a defined jurisdiction. However, paying taxes is theoretically a social obligation to contribute to public goods. To avoid inefficiencies and inequities, a quantitative tax system should include a qualitative social aspect. If the IRS could harness public opinion in auditing important economic actors, egregious tax-avoiders and the non-working rich may be motivated to contribute to the public good through taxes.

Taxation in America

In his 1906 State of the Union Address, Republican President Theodore Roosevelt stated, "The man of great wealth owes a peculiar obligation to the State, because he derives special advantages from the mere existence of government." Indeed, taxation is a social responsibility, and we divide this responsibility among citizens based on their use of government resources and ability to pay taxes. While 90 percent of Americans see paying taxes as a civic duty and the IRS estimates voluntary tax compliance is around 83 percent, the people who do not see taxation as a patriotic, social obligation create problems for the majority who do pay.

Experts estimate that the United States loses $70 billion in annual tax revenue to tax avoidance, which is nearly enough to feed the nation's poor through its food stamp program. This problem is becoming increasingly serious, as globalization allows the super-wealthy to transfer assets away fraom the markets in which they make their money and into tax havens that levy minimal taxes. Though these practices may not be socially acceptable, they are legal when they do not include the underreporting or hiding of assets.

Furthermore, the social responsibility aspect of taxation could resolve the debate over whether the wealthy pay their fair share of taxes or are taxed too much. Some commentators point out that the top 1 percent of American earners make 20 percent of national income and pay 39 percent of national income tax. Others argue that the wealthiest 1 percent of Americans owns 40 percent of the nation's wealth, and that the top 1 percent of earners pays 23.8 percent of the overall tax burden. Because income is taxed at a higher rate than wealth, these arguments talk past each other. But it is clear that a concentration of wealth in fewer hands harms the entire economy by reducing the productivity and purchasing power of more citizens.

The American public opposes tax avoidance and struggles with whether the wealthy are paying a fair share of taxes. These issues arise from imperfections of a quantitative tax code in apportioning individual tax burdens commensurate with the social obligations of each taxpayer. A new type of policy mechanism might be needed to keep taxation fair.

Enforcing the social responsibility of taxation

Taxation is assessed quantitatively and collected as a legally-enforced cost (i.e., as a market-based transaction). However, treating taxation merely as the market price of living or doing business in a government's jurisdiction may limit the effectiveness of the tax system.

Imagine two conceptions of tax-collection: (1) the IRS investigating and enforcing tax laws, and (2) the IRS passing around a hat for contributions to the public good. The first option is objective and easily enforceable, but it does not capture the social nature of taxation. While the second option may not seem realistic, consider that the IRS only audits 0.5 percent of tax returns.

Could social norms guide the assessment and collection of taxes? Behavioral scientists have found that, of the many factors motivating tax compliance, social norms are the most important. While these insights have led to effective tax-collection efforts emphasizing social norms, these might not prevent income underreporting or apply to the super-wealthy who have measurably less compassion and unique social norms.

Though the U.S. tax system operates through the enforcement of quantitative tax laws, the general effect of these laws is the promotion of social norms that support voluntary compliance. In other words, the threat of legal consequences creates a general norm or social epidemic of tax compliance. However, the normative power of these laws may be undermined, for some people, by their quantitative framework. According to behavioral scientists, market norms interfere with the perception of social value when price tags are placed on a transaction. Thus, when people approach taxation in terms of paying a cost for their citizenship and contribution to the economy, they are probably less likely to recognize the social aspects of the transaction.

Instead of only levying taxes through a market system of quantifiable costs, adding a social component could transform our taxation system and enhance tax compliance. Not only would taxes be assessed through quantitative measures of an individual's enrichment from and impact on the economy, but individuals could also be judged by the broader society.

This mechanism could take the form of a "popular tax audit."

The popular tax audit

A popular tax audit would be a democratic process in which normal citizens are given voice as to whether important players in the economy are paying their fair share.

Though the popular tax audit is entirely theoretical at this point, implementating it would not be difficult or complicated. When individuals or corporations do not seem to be contributing their fair share to the economy, to the community, or to government revenues, the IRS could gather juries of citizens and present evidence about these actors' economic activities. These juries would judge the adequacy of existing tax burdens (as an anchor) for the persons being audited and could modify their tax burdens on a case-by-case basis, similarly to how juries award damages in civil cases. That is, they could decide to lower the tax payment if they determine that overlapping taxes constitute too large a burden, expand tax liability, or order the repatriation of an amount of wealth created and earned domestically.

This process would implement a moral perspective in how tax burdens are measured, motivating wealthy individuals to focus fewer resources on tax attorneys and more resources on philanthropy and social responsibility. Also, while commentators have noted that legal tax avoidance is sometimes unethical, popular tax audits would add a layer of morality by preventing people from enjoying physical and economic presence in the developed world while offshoring wealth to places with few public costs or public goods.

Defenders of tax avoidance schemes argue that, while the practice has become an immoral scheme, it developed to avoid double and triple taxation caused by people transacting in multiple jurisdictions. Popular tax audits would not overburden globalized taxpayers because they could be sympathetic to these complex, qualitative considerations. This also means that captains of industry who create significant benefits for the economy, but are imprecise with tax compliance, would receive a balanced, sympathetic treatment in a popular tax audit.

Like the current system of quantitative tax audits, the proposed qualitative system of popular tax audits would be more notable for the effect it would have on the culture in general. By threatening the super-wealthy with the possibility of a popular tax audit, a more social perspective of taxes could be engendered. Instead of making tax avoidance illegal (creating dangers of double taxation) or alternatively using unenforceable public pressure to shame tax avoiders into paying their fair share, this solution would be flexible but also enforceable.

Using community standards to measure a social obligation

The entire point of a popular tax audit is to align access to public goods with payment of social costs in the form of taxes. Individual states and countries may be hesitant to implement this idea for fear of chasing wealth to jurisdictions that offer fewer public goods and demand fewer public costs. Two forces would prevent this: (1) taxpayers want access to economies with quality infrastructure, an educated populace, and stable government; and (2) taxpayers are affected by social norms and not just tax rates.

Because taxpayers are increasingly able to locate their wealth in tax havens, market norms would suggest that tax avoidance would be higher in countries with higher tax rates. Instead, however, a comparison of offshoring rates as percentage of GDP to income tax rates reveals that countries with higher tax rates (especially among larger economies) actually experience less offshoring. Given the weak deterrent effect of criminal laws, tax compliance appears to be affected by social norms and not merely a product of differing tax rates.

When we enforce the social responsibility of paying taxes by only threatening legal enforcement of market costs, we distort the social perception of the system. A popular tax audit should incentivize more social behavior by major economic actors within a society, allowing the community to vindicate the altruistic and levy a higher burden on greedy non-contributors.