

What's Wrong With Shaming Corporate Tax Abuse

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I. INTRODUCTION

The epidemic of corporate tax abuse—corporations' reliance on aggressive, though arguably "legal" readings of the Code to claim valuable tax benefits that Congress never intended—has been a persistent focus of the tax community over the last decade.¹ Monetary tax penalties have failed to halt this abuse. And once the government outlaws a particular tax shelter, corporations move on to exploit a seemingly infinite number of other gaps in the tax law. The absence of a silver bullet solution² has recently led some to suggest that the government consider an approach to corporate tax abuse that has been used in other contexts for thousands of years—public shaming.³

The government can impose few punishments on an offender as "dramatic and spectacular"⁴ as a shaming sanction.⁵ When the government imposes a shaming sanction, it condemns the offender in full view of the community for engaging in a socially repugnant act. By resorting to shaming, the government invites the community to take

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¹ In 1999, Treasury released a major report describing the thriving corporate tax shelter market. Treasury Dep't, *The Problem of Corporate Tax Shelters: Discussion, Analysis and Legislative Proposals* (1999), available at <http://www.ustreas.gov/offices/tax-policy/library/ctswwhite.pdf>. In addition, several significant articles written in the late 1990's focused academic attention on the corporate tax shelter problem. See, e.g., Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 *Tax Notes* 1775 (June 21, 1999); Janet Novack & Laura Saunders, *The Hustling of X-Rated Tax Shelters*, *Forbes*, Dec. 14, 1998, at 198.

² Marvin A. Chirelstein & Lawrence A. Zelenak, *Tax Shelters and the Search for a Silver Bullet*, 105 *Colum. L. Rev.* 1939 (2005) (discussing lack of a "silver bullet" solution).

³ See notes 67–86 and accompanying text.

⁴ *United States v. William Anderson Co., Inc.*, 698 F.2d 911, 913 (8th Cir. 1983).

⁵ See notes 39–49 and accompanying text.

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part in the punishment process by “heap[ing] ignominy upon”⁶ the offender. An effective shaming sanction also might deter others from emulating the shamed offender’s behavior.

Politicians, government officials, and academics have proposed a number of shaming measures that would apply to corporations that attempt to reduce their taxable income by investing in abusive tax shelters.⁷ In 2004, for example, the U.S. Senate passed legislation that would have required the Service to “make public the name” of any corporation that participated in a tax shelter.⁸ Similar proposals include requiring corporations to announce to the public instances in which they have paid certain monetary tax penalties to the Service as a result of their use of tax shelters⁹ and authorizing the Service to release publicly the details of tax shelter settlements that it enters into with large corporations.¹⁰ Each of these measures would require Congress to relax the broad confidentiality protections that currently prohibit the government from publicly disseminating information regarding taxpayer’s tax return or audit history.¹¹

The rationale for applying shaming sanctions to corporations that participate in tax shelters is that this punishment may achieve deterrence objectives that the exclusive application of monetary tax penalties cannot. Some have suggested that shaming sanctions could cause the corporation’s community—consisting of shareholders, business partners, and consumers—to ostracize the corporation and, as a result, could deter corporate managers from pursuing the offensive tax behavior. With varying degrees of success, the federal and state governments have deployed shaming sanctions to reduce other types of tax noncompliance, including taxpayers’ delinquency in paying taxes, failure to file tax returns, and refusal to make required disclosures to the Service.

This Article considers the merits of public shaming as a deterrent of corporate tax abuse. While several commentators have focused on the potential advantages of shaming as a response to corporate tax

⁶ Stephen P. Garvey, *Can Shaming Punishments Educate?*, 65 *U. Chi. L. Rev.* 733, 737 (1998).

⁷ See notes 67-86 and accompanying text.

⁸ *Jumpstart Our Business Strength (JOBS) Act*, S. 1637, 108th Cong. § 402, 150 Cong. Rec. S. 5622, 5643 (May 18, 2004), discussed at notes 74-77 and accompanying text.

⁹ *Id.*

¹⁰ See Dustin Stamper, *Korb Pledges Careful Use of Press, More Guidance on Disclosures*, 2006 *TNT* 206-2 (Oct. 25, 2006); available in LEXIS, Tax Analysts File; Donald Korb, *The War on Tax Shelters*, Speech at NYU School of Law (Mar. 6, 2007) (discussing IRS approach of releasing press releases regarding tax shelter settlements with large corporations)(notes on file with author).

¹¹ See IRC § 6103(a).

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abuse,¹² this Article examines their potential disadvantages. My claim is that, in contrast to their successful use in other tax enforcement contexts, shaming sanctions would likely fail to deter corporations from pursuing abusive tax shelters and, instead, could have the unintended effect of weakening important aspects of tax compliance. As a result, I conclude that shaming should be rejected as a means of reducing corporate tax abuse.

There are several significant reasons to question whether shaming sanctions would be effective in deterring corporations from pursuing abusive tax shelters. First, little evidence supports the claim that publicity of a corporation's tax shelter activity would lead to ostracism of the corporation. When the press has reported on high-profile public tax shelter litigation in the past, the corporations involved have not suffered significant drops in stock price, consumer boycotts of their goods, or calls for management reform, even in cases where courts have issued resounding pronouncements in favor of the government. If past public reaction is any guide, shaming sanctions for corporate tax abuse would be unlikely to inflict significant reputational harm on corporate offenders and, as a result, their deterrence value would be weak. By contrast, when governments have publicly shamed corporations and other taxpayers for failing to abide by clear tax rules, such as a requirement to timely pay outstanding tax liabilities, public reaction has been negative.

Second, publicized information that a particular corporation has engaged in abusive tax planning could actually send an unintended *positive* signal to the members of a corporation's community. Short-term investors, like hedge and private equity funds, may be attracted to, rather than repelled by, corporations with tax directors who claim tax positions that "push the envelope." Investors could respond much more favorably to news that a corporation attempted to cut its tax expense by investing in a tax shelter than to news that the corporation blatantly ignored an explicit tax rule, such as by failing to file a tax return at all. The potentially positive signal that a shaming sanction for corporate tax abuse could emit, consequently, could significantly diminish its deterrence value.

Finally, it is possible to surmise that the negative public reaction that shaming sanctions might inflict would resonate with tax directors who may fear personal loss, such as termination of their employment. Anxiety over the risk of personal loss, in theory, could deter corporate managers from claiming overly aggressive tax positions. There are two reasons, however, to reject this speculation. First, when a corporation's tax shelter activities have been exposed publicly in the past,

¹² See notes 87-105 and accompanying text.

the tax director of the corporation involved did not suffer adverse professional consequences. Second, by the time the Service discovers a corporation's participation in a tax shelter, the tax director who originally authorized it no longer may be affiliated with the corporation.

In addition to failing to achieve deterrence objectives, shaming sanctions could have the unintended effect of weakening important aspects of tax compliance. Some corporate tax directors could respond to these sanctions by *increasing* their use of aggressive tax planning techniques. As reciprocity theory hypothesizes, actors may reduce their own contributions toward a public good if they begin to feel like "chumps" for complying while others cheat.¹³ As a result of public reports that well-known, respected corporations have authorized the use of abusive tax shelters, conservative tax directors could develop the impression that their historic tax reporting practices have been *too* cautious. In response, these tax directors may increase their use of aggressive corporate tax strategies.

Shaming sanctions also could trigger harmful forms of backlash from tax directors and from the general taxpaying public. Some tax directors could react to the threat of shaming sanctions, at least in the short term, by "overdisclosing" information to the Service. The overdisclosure strategy could enable tax directors to technically comply with the tax shelter reporting rules, while simultaneously limiting the ability of the Service to detect the corporation's use of abusive tax strategies that would likely result in the application of shaming sanctions. In addition, the use of shaming sanctions for this particular offense could weaken general taxpaying morale. Instead of repudiating the corporations subject to shaming sanctions, the general taxpaying public could show contempt toward the government for enacting "loopholes" in the corporate tax law that corporations exploited.

Finally, the government's threat of shaming sanctions for corporations that participate in tax shelters could increase the amount of tax shelter litigation. Current law allows a corporation to settle a tax shelter dispute or pay a monetary penalty to the Service behind a curtain of taxpayer confidentiality. By pulling back that curtain, shaming sanctions could encourage a corporation's managers to resort to the courts to challenge the Service's *ex post* characterization of a particular transaction as a tax shelter rather than accept a public branding from the Service as a tax shelter participant. The danger of increased litigation in the tax shelter area is that it would drain significant tax enforcement resources and could increase the risk of high-profile government losses.

¹³ For further discussion, see Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 *Ohio St. L.J.* 1453, 1487 (2003).

The remainder of this Article proceeds as follows: Part II discusses the corporate tax abuse problem and the rise of shaming as a possible response. Part III suggests why shaming sanctions would fail to deter corporations from pursuing abusive tax shelters. Part IV argues that, in addition to failing to achieve deterrence objectives, shaming sanctions could have the adverse effect of weakening important aspects of tax compliance. Part V concludes.

II. SHAMING AS A RESPONSE TO CORPORATE TAX ABUSE

A. *The Corporate Tax Abuse Problem*

There is no universal definition of a corporate tax shelter.¹⁴ A tax shelter is a complex transaction that may appear to comply with the text of the Code, yet it provides its corporate user with valuable tax benefits that Congress never envisioned.¹⁵ As Michael Graetz once famously commented, a corporate tax shelter is “a deal done by very smart people that, absent tax considerations, would be very stupid.”¹⁶

Consider just a few highly simplified examples of representative corporate tax shelters:

- A series of complicated exchanges involving “contingent liabilities” between a corporation and its wholly-owned subsidiary that enables the corporation to claim a large tax loss that just happens to precisely offset a large tax gain.¹⁷
- A purchase of several million dollars worth of stock by a corporation that then sells the stock back to its original owner minutes later, resulting in the corporation’s access to millions of dollars in valuable foreign tax credits.¹⁸

¹⁴ See, e.g., Calvin H. Johnson, What’s a Tax Shelter?, 68 Tax Notes 879, 879 (Aug. 14, 1995) (“There is no consensus definition of a ‘tax shelter’ in the law or legal literature.”). The most concrete guidance that the Code provides is that it describes a “tax shelter” as a transaction with a “significant purpose of . . . avoidance of Federal income tax.” IRC § 6662(d)(2)(C).

¹⁵ See Treasury Dep’t, note 1, at 130 (describing corporate tax shelter as “a transaction specifically designed to exploit a provision of the law in unintended ways”); Bankman, note 1, at 1777 (“The tax shelter . . . produces a result that is inconsistent with commonly understood tax principles and is not supported by clearly defined legislative intent.”). For a discussion of the role that Congress’ intent should play in defining a transaction as a tax shelter, see Leandra Lederman, W(h)ither Economic Substance?, 95 Iowa L. Rev. ___ (forthcoming, 2010), available at <http://ssrn.com/abstract=1345388>.

¹⁶ Tom Herman, Tax Report, Wall St. J., Feb. 10, 1999, at A1.

¹⁷ Black & Decker Corp. v. United States, 436 F.3d 431 (4th Cir. 2006) (contingent liability tax shelter).

¹⁸ Compaq Computer Corp. v. Commissioner, 277 F.3d 778 (5th Cir. 2001) (dividend-stripping tax shelter).

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- A multi-step transaction between a corporation and a Cayman Islands bank that allows the corporation to “inflate” its tax basis in stock and then incur a large tax loss by quickly selling that stock.¹⁹

In each of these transactions, the corporation did not stand to make a pretax economic profit. As a result, these deals are what Graetz would call “very stupid.” Yet, the corporate managers who authorized these transactions considered them to be very smart deals. In each case, under a hyper-literal reading of the applicable tax law, the transaction produced a large tax loss or valuable tax credit that—like magic—seemed to cause significant corporate tax liability to disappear.

At the time corporations entered into these transactions, no tax *rules* explicitly prohibited them. In fact, they technically complied with the tax rules then in effect.²⁰ The Service, and at least some courts, however, concluded that these transactions were corporate tax shelters because they violated broad judicial tax *standards*.

Whether a particular law enables an actor to determine in advance that his conduct is permissible is the feature that distinguishes a rule from a standard.²¹ A rule is definite, concrete guidance that dictates *ex ante* whether an actor may engage in specific conduct.²² A standard, on the other hand, consists of broad factors or guidelines that only a judge or another adjudicator can apply *ex post* to determine with certainty whether the actor’s conduct was permissible.²³ A violation of a rule, for example, occurs when an individual drives her car at 90 miles per hour, despite the presence of a roadside sign that clearly states “Speed Limit: 65 Miles Per Hour.” A violation of a standard, on the other hand, would have occurred if the roadside sign had instead read “No Driving at Excessive Speeds.”

¹⁹ Notice 2001-45, 2001-2 C.B. 129 (basis-shifting tax shelter).

²⁰ For example, in the contingent liability tax shelter, the corporate taxpayer would contribute cash plus contingent liabilities to a controlled subsidiary in exchange for stock in a tax-free incorporation. See IRC § 351. While the corporation’s tax basis in its newly received stock in the subsidiary would normally equal the value of the cash contributed reduced by any liabilities assumed by the subsidiary, the corporation would argue that under the tax law at the time, it was not required to reduce its basis in the subsidiary stock because the liabilities were “contingent” on future events. See IRC § 357(c)(3); Rev. Rul. 95-74, 1995-2 C.B. 36. The corporation then would sell its subsidiary stock for its fair market value to a related entity and recognize a large tax loss. See, e.g., *Black & Decker* 436 F.3d 431. For a thorough discussion of this transaction, see Ethan D. Yale, Reexamining Black & Decker’s Contingent Liability Tax Shelter, 108 Tax Notes 223 (July 11, 2005).

²¹ See Louis Kaplow, Rules Versus Standards: An Economic Analysis, 42 Duke L.J. 557, 560 (1992); see also Kyle D. Logue, Tax Law Uncertainty and the Role of Tax Insurance, 25 Va. Tax Rev. 339, 363-68 (2005) (discussing rules/standards distinction in tax law).

²² Kaplow, note 21, at 560.

²³ *Id.*

Upon reviewing the tax returns of the corporations that participated in the transactions described above, the Service concluded that the tax benefits resulting from these transactions were inconsistent with the “economic substance” and “business purpose” tax standards.²⁴ The Service determined that the real purpose of each transaction was for the corporation that pursued it to enjoy valuable tax benefits, not to further any non-tax-related business objective or generate a pretax profit.²⁵

In the absence of comprehensive reform to the substantive tax law, the government has adopted several second-best measures to address the corporate tax abuse problem. These measures have provided the government with limited tools for halting the spread of abusive tax strategies among corporate taxpayers.

The Service’s use of broad anti-abuse tax standards has had mixed success.²⁶ Corporations plan around these tax standards.²⁷ At least one court has held that a transaction did not violate the business purpose tax standard even though the taxpayer entered into it “primarily to get otherwise unavailable tax benefits in order to offset unrelated tax liabilities and unrelated capital gains.”²⁸ Another court has taken the position that tax shelter standards are retroactive, “judge-made” law and cannot be applied to trump the literal words of the Code.²⁹

While Congress has enacted explicit tax rules that prohibit corporations from claiming tax benefits using certain abusive tax strategies, it almost always has done so *after* large numbers of taxpayers have engaged in them.³⁰ Once Congress learned of the contingent liability tax shelter, for example, it enacted a targeted statutory fix to prevent corporations from using this technique in the future.³¹ As Congress affirmatively outlaws newly discovered corporate tax shelters by statute,

²⁴ *Black & Decker Corp. v. United States*, 436 F. 3d 431, 440-43(4th Cir. 2006); *Compaq Computer Corp. v. Commissioner*, 277 F. 3d 778, 781-88 (5th Cir. 2001); Notice 2001-45, 2001-2 C.B. 129, 129. For discussion, see, e.g., Joseph Bankman, *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5 (2000); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 Tax Law. 235 (1999).

²⁵ See *Black & Decker*, 436 F.3d. at 440-43; *Compaq* 277 F.3d at 781-88; Notice 2001-45, 2001-2 C.B. 129, 129.

²⁶ See Chirelstein & Zelenak, note 2, at 1940.

²⁷ Or as Senator Carl Levin once commented of the economic substance doctrine, corporations construct “all of this mumbo jumbo, all of these boxes and arrows . . . to create an impression of economic activity when there is none.” 150 Cong. Rec. S. 5191, 5214 (May 11, 2004) (statement of Sen. Levin).

²⁸ *Compaq*, 277 F.3d at 786.

²⁹ See, e.g., *Coltec Industries, Inc. v. United States*, 62 Fed. Cl. 716, 755 (2004), rev’d, 454 F.3d 1340 (Fed. Cir. 2006) (quoting Justice Scalia, “Judge-made law is ex post facto law . . .”).

³⁰ See Chirelstein & Zelenak, note 2, at 1941, for further discussion.

³¹ IRC § 358(h).

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corporations stop using those strategies and move on to exploit other gaps in the tax law.³²

Monetary tax penalties also have had limited effect in deterring corporate tax abuse. Assuming corporate tax directors act like other rational actors, they weigh the potential costs and benefits of a particular tax strategy before engaging in it.³³ As a result of the low probability that the Service will detect and challenge successfully most corporate tax shelters, tax directors discount the potential monetary tax penalties that may result from engaging in an abusive tax strategy.³⁴

Finally, the government has enacted mandatory disclosure rules as a mechanism for increasing the probability of detection and deterring participation in abusive tax strategies.³⁵ Under this regime, corporations must report to the Service their participation in transactions that the Service specifically has designated as abusive “listed transactions,”³⁶ as well as in transactions that bear more general tax shelter traits.³⁷ Like Congress’ enactment of targeted statutory solutions, however, the mandatory disclosure regime produces cat-and-mouse dynamics between the Service and corporations such that corpora-

³² Chirelstein & Zelenak, note 2, at 1950 (“[T]he government cannot win this game.”). As Daniel Shaviro has written, the Service’s designation of a particular tax strategy as a listed transaction often stops corporate managers from continuing to exploit that strategy because the Service “would have to be radically and surprisingly wrong if it did not consistently succeed in identifying transactions that have at least some significant chance of losing on economic substance, business purpose or similar grounds.” Daniel N. Shaviro, *Disclosure and Civil Penalty Rules in the U.S., Legal Response to Corporate Tax Shelters* (NYU School of Law & Econ. Research Paper Series, Working Paper No. 07-05, 2007), available at <http://ssrn.com/abstract=955354>.

³³ See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 *J. Pol. Econ.* 169 (1968); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 *Colum. L. Rev.* 569 (2006) (discussing the expected value analysis that tax directors perform).

³⁴ See Raskolnikov, note 33, at 571.

³⁵ Reg. § 1.6011-4 (taxpayer disclosure requirements); Reg. § 301.6111-3(d)(1) (material advisor disclosure requirements).

³⁶ Reg. § 1.6011-4(b)(2). The Service maintains the list of abusive tax shelters on its website, available at <http://www.irs.gov/businesses/corporations/>.

³⁷ Reg. §§ 1.6011-4(b)(3), (4), (5) (providing disclosure obligations regarding confidential transactions, transactions with contractual protection, and loss transactions). In certain cases, these reporting obligations apply even though a particular transaction was not subject to mandatory disclosure rules at the time corporate taxpayers engaged in it. Corporations must report to the Service their participation in transactions that become listed transactions after corporations have entered into them using Form 8886 and must file a disclosure statement with the Service’s Office of Tax Shelter Analysis within ninety calendar days after the date on which the transaction became a listed transaction. Reg. § 1.6011-4(e)(2)(i).

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tions cease participating in listed transactions and explore other tax avoidance strategies that are not subject to mandatory disclosure.³⁸

B. Considering Shaming

The lack of effective monetary penalties and comprehensive anti-abuse standards under current law has forced politicians, government officials, and academics to search for alternative approaches to the corporate tax abuse problem. The age-old practice of shaming has emerged as one such alternative.

This Section provides a general overview of shaming, describes past uses of shaming sanctions as a means of promoting tax compliance, and examines recent proposals to empower the government to use similar techniques against corporations that pursue abusive tax shelters.

1. What Is Shaming?

Social institutions have used shaming as a mechanism for preserving social order for thousands of years. In ancient Rome, the doors to the homes of criminals were branded to alert the public of the deeds of the residents who lived behind them.³⁹ In colonial America, offenders of certain customs were famously locked in pillories and subjected to a barrage of rotten vegetables from the disapproving crowd.⁴⁰ In modern times, creative judges have sentenced felons to wear bright orange vests that proclaim “I AM A DRUNK DRIVER”⁴¹ and local jurisdictions have published in their town newspapers the names of individuals who have participated in a variety of offensive activities, such as the solicitation of prostitutes⁴² and public urination.⁴³

In each of these examples, a social institution condemns an actor for violating a shared moral norm and issues the condemnation in a dra-

³⁸ See Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 *UCLA L. Rev.* 1629, 1642-52 (2009) (discussing taxpayer techniques for avoiding mandatory disclosure obligations).

³⁹ See Roland Muller, *Honor and Shame: Unlocking the Door* 53 (2000) (describing Roman shaming).

⁴⁰ For a graphically detailed description of these punishments, see Alice Morse Earle, *Curious Punishments of Bygone Days* 28-50, 87-95 (Singapore Tree Press 1968) (1896).

⁴¹ This practice has been implemented in Tennessee. T.C.A. § 55-10-403(s)(5).

⁴² See Courtney Guyton Persons, *Sex in the Sunlight: The Effectiveness, Efficiency, Constitutionality, and Advisability of Publishing Names and Pictures of Prostitutes' Patrons*, 49 *Vand. L. Rev.* 1525 (1996).

⁴³ See Clifford J. Levy, *Cracking Down in a Drinking Town; Hoboken Battles Public Urination*, *N.Y. Times*, July 9, 1994, at A21 (describing the fight against public urination in Hoboken, New Jersey), discussed in Dan M. Kahan & Eric A. Posner, *Shaming White-Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines*, 42 *J.L. & Econ.* 365, 365 (1999).

matic and public fashion. Shaming sanctions do not require the offender to pay a monetary fine or endure physical incarceration. Rather, they alert the offender's community to his actions and, when they are effective, provoke communal ostracism of the offender. As Dan Kahan and Eric Posner have defined shaming, it is "the process by which citizens publicly and self-consciously draw attention to the bad dispositions or actions of an offender, as a way of punishing him for having those dispositions or engaging in those activities."⁴⁴

Anthropological and psychological studies regarding the influence of shaming sanctions on a community's treatment of an offender and its deterrent effect on potential offenders imply that certain factors must be present for a shaming sanction to achieve its desired effect.⁴⁵ Toni Massaro has synthesized from these studies the following four factors that she argues are critical to the success of a shaming sanction:

First, an offender subject to a shaming sanction must belong to an identifiable community, such that its members would recognize the offender.⁴⁶

Second, the shaming sanction must adversely affect the offender's social status in the community, resulting in public scorn and communal ostracism of the offender.⁴⁷

⁴⁴ Kahan & Posner, note 43, at 368. Shaming as a method of punishment has been subject to significant criticism in the legal literature, especially when applied against individual offenders, rather than entities or institutions. Martha Nussbaum, for instance, has argued that when a judge imposes a shaming sanction on an individual convicted of drunk driving, the judge aims to "mark a person as having a deviant identity" and invite the public "to scoff at the person's spoiled identity." Martha C. Nussbaum, *Hiding from Humanity: Disgust, Shame, and the Law* 230-31 (2004). In Nussbaum's view, such state-sponsored forms of shaming are "incompatible with the proper public regard for the equal dignity of all citizens." *Id.* at 231.

Criminal law scholars have offered significantly less criticism, and even acceptance, of shaming when applied against corporations. In contrast, to her criticism of shaming as applied to individual offenders, Nussbaum, for example, has written that "shaming penalties might be appropriate for organizations that do harm, where they would be inappropriate as applied to individuals . . . [because] organizations cannot suffer the deep harms that individuals suffer." *Id.* at 244. For criminal law scholars like Nussbaum, a shaming measure applied to a corporation does not appear to provoke dignity concerns.

⁴⁵ Toni M. Massaro, *Shame, Culture, and American Criminal Law*, 89 *Mich. L. Rev.* 1880, 1883 (1991) (discussing anthropological and sociological studies regarding shaming sanctions).

⁴⁶ *Id.* Massaro has argued that because communities today consist of millions of individuals, a shaming sanction applied against one of these individuals may be unlikely to provoke communal ostracism. *Id.* at 17 ("Unlike the intimate face-to-face cultures that rely heavily on shaming, cities in the United States typically are not characterized by high interdependence among citizens, strong norm cohesiveness, or robust communitarianism.").

⁴⁷ *Id.* at 1883.

Third, potential offenders must fear the imposition of a shaming sanction, which should deter them from pursuing the offensive conduct at issue.⁴⁸

Last, procedures must exist to reintegrate the offender into the community at some future point, so that members of the community maintain respect for the institution that applies the shaming sanction.⁴⁹

2. *Past Uses Against Tax Noncompliance*

Just as social institutions have attempted to publicly shame actors who have participated in socially undesirable activities such as environmental pollution or sex offenses, they also have applied this form of punishment against taxpayers who have failed to comply with various aspects of the tax system. Three prominent examples of tax offenses for which governments and courts have applied shaming sanctions include taxpayers' delinquency in paying an established tax liability, failure to file tax returns, and refusal to make required disclosures to the Service.⁵⁰

Failure to Pay. Over a third of the nation's states have showcased the identities of businesses and individuals that have failed to pay their outstanding tax liability on time by using dramatic public websites⁵¹ like Maryland's "Caught in the Web,"⁵² South Carolina's "Debtor's Corner,"⁵³ and Wisconsin's "Website of Shame."⁵⁴

⁴⁸ Id.

⁴⁹ Id.

⁵⁰ The following are not the only examples of past uses of shaming sanctions in tax enforcement. One example that I do not discuss is the federal government's attempts to shame individual U.S. taxpayers who expatriate in order to reduce their tax liabilities. For discussion of that provision, see Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 Iowa L. Rev. 863 (2004).

⁵¹ Ben Jones, *Latest Tax Tool: "Internet Shaming; States Try to Embarrass Debtors into Paying by Posting Their Names"* USA Today, Dec. 23, 2005 at A1 ("At least 18 states have launched websites to post the names of people and businesses that owe back taxes.").

⁵² Comptroller of Maryland, *Caught in the Web*, at http://compnet.comp.state.md.us/Compliance_Division/Collections/General_Collections_Information/Caught_in_the_Web.shtml (last visited Sept. 29, 2009).

⁵³ South Carolina Dep't of Revenue, *Debtor's Corner*, at <http://www.sctax.org/delinquent/delinquent.shtml> (last visited Sept. 27, 2009).

⁵⁴ Wisconsin Dep't of Revenue, *Wisconsin Delinquent Taxpayers*, at <http://www.revenue.wi.gov/html/delqlist.html> (last visited Sept. 27, 2009); see also Spies Online, *Delinquent Taxpayers*, <http://www.spiesonline.net/delinquent-taxpayers.shtml> (last visited Sept. 27, 2009) (providing access to state shaming websites). Since 2007, the California Franchise Tax Board has published an annual list of the top 250 taxpayers with liened state income tax delinquencies of greater than \$100,000. See <http://www.ftb.ca.gov/individuals/txdlnqnt.shtml> (last visited Jan. 20, 2009). Celebrities such as Burt Reynolds, O.J. Simpson, Dionne

The mechanics of most states' shaming programs are relatively simple. In Wisconsin, the Department of Revenue identifies taxpayers that owe more than \$5,000 in assessed, unpaid state tax liability.⁵⁵ After their appeal rights have expired and there is no legal dispute as to the amount of outstanding tax liability, the Department of Revenue mails a "Notice of Pending Internet Posting" to these taxpayers warning them that if they do not make payment, their names and amounts of outstanding tax liabilities will be posted on the Website of Shame.⁵⁶

State revenue agencies report that taxpayers have responded positively to the shaming campaigns, paying millions of dollars in outstanding taxes in recent years. When the Wisconsin Department of Revenue inaugurated the Website of Shame in January 2005, for example, it anticipated that it would collect \$1.5 million in unpaid tax liability during its first year of operation.⁵⁷ One year later, the department reported that it had collected over *fifteen times* that amount from previously unreachable taxpayers from Oshkosh to Sheboygan to Waukesha, and that payment checks continued to arrive each day.⁵⁸ Other states that have implemented delinquent taxpayer websites have reported that the approach has enabled them to collect hundreds of millions of dollars.⁵⁹ State revenue officials also have reported that from the start to finish of each year, the number of names on their lists of delinquent taxpayers has decreased as taxpayers pay outstanding tax liabilities.⁶⁰

Failure to File. Courts often apply shaming sanctions against defendants who have failed to file federal tax returns. The Colorado Supreme Court, for example, has frequently sentenced attorneys who

Warwick, and Sinbad have appeared on the list. See 3 Celebrities on List of California Tax Evaders, L.A. Times, Apr. 10, 2009, at A3.

⁵⁵ Wis. Stat. § 73.03(62); Wisconsin Dep't of Revenue, Wisconsin Delinquent Taxpayers, available at <http://www.revenue.wi.gov/html/delqlist.html> (lowering threshold tax delinquency for public posting from \$25,000 to \$5,000).

⁵⁶ Wis. Stat. § 73.03(62). The Wisconsin Department of Revenue does not post taxpayers' information if they have entered agreements to settle their tax liability or if they are bankrupt. *Id.*

⁵⁷ Editorial, Shaming Scofflaws Seems To Be Working, Sheb. Press, Jan. 2, 2007, available at <http://www.sheboygan-press.com/apps/pbcs.dll/article?AID=/20070102/SHE06/701020365/1883> (citing reports on progress of Website of Shame).

⁵⁸ *Id.*

⁵⁹ Kristen Wyatt, States Use Shame as Tax Collecting Tool: Web Sites Publish Name of Residents with Delinquent Bills, Wash. Post, May 9, 2004, at A10 (describing reports from state revenue officials on success of shaming websites); Stephen W. Mazza, Taxpayer Privacy and Tax Compliance, 51 U. Kan. L. Rev. 1065, 1133 (2003) (commenting on the positive results of shaming websites, including those of Connecticut and Massachusetts).

⁶⁰ Steven Walters, Taxpayer List Scares Up Cash, Mil. J. Sentinel, May 30, 2006, at B3 (reporting on decreases of number names on Wisconsin's delinquent taxpayer list from January 1, 2006 to mid-May, 2006).

consistently fail to file federal tax returns to “public censure” for committing acts of “dishonesty, fraud [and] deceit.”⁶¹

Commentators have noted that the use of shaming sanctions for failure to file a tax return may be especially effective in cases where the offender’s reputation for integrity within his local community is central to his ability to earn a living. With respect to cases involving lawyers, Leslie Levin has written that, compared to ordinary citizens, these actors “usually value their reputations within the larger community and may be more likely to respond to shaming sanctions.”⁶² Courts and attorney grievance committees, accordingly, have relied on shaming sanctions as a way to discourage lawyers and others from ignoring their obligations to comply with tax return filing requirements.

Failure to Disclose. A final example of shaming as a means of tax enforcement can be found in the Code’s treatment of corporations that fail to make certain required disclosures of information to the Service.

As noted above, the Service frequently designates certain tax strategies as “listed transactions,” its formal name for abusive tax shelters. When the Service designates a particular strategy as a listed transaction, corporations are required to inform the Service if they participate in that transaction in the future. If the Service designates a strategy as a listed transaction *after* a corporation has already used it to claim tax benefits, the corporation may be required to disclose to the Service after the fact.⁶³ Failure to disclose participation in listed transactions subjects corporations to a nonwaivable \$200,000 tax penalty for each offense.⁶⁴ The shaming aspect of these rules is that the Code also requires a corporation that pays a penalty for failing to comply with these disclosure requirements to report the payment in public filings with the Securities and Exchange Commission.⁶⁵

Shaming sanctions for failure to disclose required information appear to have had some success in encouraging corporate tax directors to adopt a more rigorous approach to disclosure. In response to the threat of these sanctions, tax directors, lawyers, and accountants have engaged in numerous public discussions regarding procedures that

⁶¹ See, e.g., *People v. Borchard*, 825 P.2d 999 (Colo. 1992); *People v. Tauger*, 893 P.2d 121 (Colo. 1995) (sentencing defendants to public censure for failing to file federal income tax returns in multiple years).

⁶² Leslie C. Levin, *The Emperor’s Clothes and Other Tales About the Standards for Imposing Lawyer Discipline Standards*, 48 Am. U. L. Rev. 1, 75 n.342 (1998).

⁶³ Reg. § 1.6011-4(e)(2)(i).

⁶⁴ IRC § 6707A(b)(2).

⁶⁵ IRC § 6707A(e)(2).

corporations should adopt to ensure that they comply with the Service's disclosure requirements.⁶⁶

3. *Proposed Uses of Shaming Against Corporate Tax Abuse*

As traditional approaches to the corporate tax abuse problem have proven inadequate, politicians, government officials, and academics have proposed that the federal government consider applying shaming sanctions similar to the measures described above against corporations that pursue abusive tax shelters.

Jay Soled and Dennis Ventry, for instance, have suggested that public shaming could be implemented to reduce the federal "tax gap," the difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.⁶⁷ As Soled and Ventry have argued, "Enforcement through shaming could attack all forms of tax abuse. These include high-income and corporate taxpayers who take artificial losses to offset taxable gains."⁶⁸ Rather than restricting their support for shaming to measures directed toward individual taxpayers or tax delinquents, Soled and Ventry favor the use of shaming to punish corporations that engage in the type of abusive tax shelters discussed above.⁶⁹ Other tax scholars have offered similar sentiments regarding the merits of shaming corporations that participate in abusive tax planning.⁷⁰

To enact shaming sanctions along the lines of those that tax scholars have suggested, the government first would need to make substantive revisions to confidentiality restrictions under current law. Section 6103 of the Code prohibits the Service from publicly disseminating information related to a specific taxpayer's tax return—including any corporate taxpayer—such as the amount of its tax liability, payment of

⁶⁶ For a representative sampling, see, e.g., Christian M. McBurney, Public Companies Need to Identify Reportable Transactions to Avoid SEC Disclosure, 103 J. Tax'n 5 (2005) (outlining formal written procedures that tax directors should adopt to avoid disclosure failures); Herbert N. Beller, The New Penalty Regime: Proceed with Caution!, 106 Tax Notes 311 (Jan. 17, 2005) (describing significance of shaming sanctions for non-disclosure).

⁶⁷ Jay A. Soled & Dennis J. Ventry, Jr., A Little Shame Might Just Deter Tax Cheaters, USA Today, Apr. 10, 2008, at 12A. Soled and Ventry further argue that a federal shaming program should be implemented to address "wayward tax advisers." *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ See, e.g., Marjorie E. Kornhauser, Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?, 18 Can J. Law & Jur. 95, 112 (2005) ("Limiting publicity to public corporations has distinct advantages. Not only would it target some of the largest taxpayers (with the largest deficiencies), but it would also focus on a compliance problem much in the public awareness"); Linda M. Beale, Putting SEC Heat on Audit Firms and Corporate Tax Shelters: Responding to Tax Risk with Sunshine, Shame and Strict Liability, 29 J. Corp. L. 219, 222 (2004) (offering public disclosure proposals designed to "to shame the participants and purveyors of potentially abusive tax shelter transactions").

civil tax penalties, and results of audits.⁷¹ In its own internal manual, the Service warns its employees to avoid any public disclosure that could “damage the reputation of the taxpayer.”⁷²

In recent years, politicians and government officials have offered several proposals to amend or circumvent the taxpayer confidentiality rules under current law to empower the federal government to apply public shaming sanctions against participants in corporate tax abuse. These proposals reflect the arguments in favor of shaming sanctions for corporate tax abuse that tax scholars have offered.⁷³ Three of these proposals—public shaming lists for corporate tax abuse participants, public tax shelter penalties, and public tax shelter settlements—are discussed briefly below.

Public Shaming Lists. In 2004, the Senate passed legislation that would have required the Service to inform the public of the identities of corporations that participated in tax shelters. The legislation would have required the Service “to make public the name” of any corporation that would be required to pay a penalty attributable to a transaction that lacks economic substance.⁷⁴ Under the legislation, a transaction would lack economic substance if it did not result in a meaningful change in a taxpayer’s economic position, apart from tax effects, and failed to serve a substantial nontax purpose.⁷⁵ The Service would likely have used its website to compile a list of corporations that engaged in “non-economic substance” transactions, just as state taxing authorities have used the internet to publicize the identities of individuals and business that are delinquent in paying established tax liabilities.⁷⁶ Senator Charles Grassley, the Senate Finance Committee Chairman, implied that the Service’s public announcements would punish the featured corporations by causing their current and future shareholders to reconsider “whether they want to invest in a company with clouded business ethics.”⁷⁷

Public Tax Shelter Penalties. A related provision of the 2004 legislation would have obligated corporations to disclose publicly their payment of any penalties for engaging in non-economic substance

⁷¹ IRC § 6103(a).

⁷² IRS, Internal Revenue Manual, Handbook for Special Agents, § 347.2, at 9781-11.

⁷³ See Beale, note 70, at 222; Kornhauser, note 70, at 112; Soled & Ventry, note 67, at 12A.

⁷⁴ Jumpstart our Business Strength (JOBS) Act, S. 1637, 108th Cong. § 402, 150 Cong. Rec. S. 5622, 5643 (May 18, 2004).

⁷⁵ Id. § 401.

⁷⁶ See notes 51–60 and accompanying text.

⁷⁷ Press Release, Senator Charles Grassley, Grassley Highlights Corporate Loophole Closers in New Tax Bill (Oct. 14, 2004), available at <http://finance.senate.gov/press/Gpress/2004/prg101404.pdf>.

transactions.⁷⁸ Under current law, a corporation's managers have significant discretion over whether to reveal publicly that the corporation has participated in an abusive tax shelter. If a corporation pays a monetary tax penalty to the Service for engaging in a tax shelter, the corporation may not describe this payment in a public filing with the Securities and Exchange Commission if its managers do not consider the event to be "material."⁷⁹ Even if it is material, they may use vague language to report the event.⁸⁰ This proposal would have guaranteed that a corporation inform shareholders, employees, and the media of instances in which it had paid a monetary tax penalty to the Service for engaging in an abusive tax strategy.

Public Tax Shelter Settlements. Last, the Service recently has begun experimenting with shaming sanctions by making public announcements of its tax shelter settlements with large corporations. Generally, any settlements between the Service and corporate taxpayers are protected by confidentiality rules.⁸¹ The Service, however, has begun to enter settlement agreements with corporations that have claimed tax benefits using tax shelters, but it has insisted that as a condition of the settlement, the corporations sign confidentiality waivers.⁸² Describing the technique, Donald Korb, the former Chief Counsel of the Service, explained that when a corporation expresses an interest in resolving a potential tax shelter dispute, "we say okay, but as part of the settlement, we'll put out a press release naming you."⁸³ The typical press release may describe the corporation's participation in an abusive tax shelter and the terms of the settlement, including the tax liability, penalties, and interest ultimately owed.⁸⁴ While the practice is still in its infancy, the Service has issued press releases in tax shelter settlements with major corporations⁸⁵ and is considering increased use of this approach.⁸⁶

⁷⁸ Jumpstart our Business Strength (JOBS) Act, S. 1637, 108th Cong. § 402, 150 Cong. Rec. S. 5622, 5643 (May 18, 2004).

⁷⁹ SEC Regulation S-K, Item 103, 17 C.F.R. § 229.103 (2006).

⁸⁰ See Beale, note 70, at 247 ("Any material information about risky tax transactions tends to be hidden . . .").

⁸¹ IRC § 6103(a).

⁸² See Stamper, note 10 (summarizing public press release approach).

⁸³ Korb, note 10.

⁸⁴ *Id.*

⁸⁵ See, e.g., Press Release, IRS, IRS Accepts Settlement Offer on Contingent Liability Tax Shelter (Dec. 16, 2004), available at <http://www.irs.gov/newsroom/article/0,,id=132350,00.html> (Hercules settlement); Press Release, IRS, Merck Agrees to Pay IRS \$2.3 Billion (Feb. 14, 2007), available at <http://www.irs.gov/newsroom/article/0,,id=167773,00.html> (Merck settlement).

⁸⁶ See Stamper, note 10.

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C. *Why Shame Corporate Tax Abuse?*

Politicians, government officials, and tax scholars have suggested that the use of shaming sanctions in the corporate tax abuse context could be an effective deterrent.⁸⁷ This Subpart outlines three possible arguments in favor of such shaming measures: (1) they would apply against recognizable offenders that are members of identifiable communities; (2) they would result in communal ostracism; and (3) they would discourage corporate managers from engaging in abusive tax planning.

1. *Recognizable Offenders*

The use of shaming sanctions against corporations that pursue abusive tax shelters would expose the actions of easily recognizable actors that belong to identifiable communities. As Massaro's analysis summarized above demonstrates, unless the offender that is subject to a shaming sanction is recognizable within a community, the threat of ostracism or reputational damage resulting from a shaming sanction is weak.⁸⁸

The corporations that have participated in abusive tax shelters since the late 1990's, however, have been some of the most well-known blue chip corporations. Proponents of the corporate tax abuse shaming measures described above would likely argue that the corporations that could be subject to them would be recognizable offenders that belong to various identifiable communities—consisting of shareholders, stock analysts, business partners, employees, consumers, and the press—that are capable of ostracism and damage to social status.⁸⁹ As criminal law scholars Brent Fisse and John Braithwaite concluded in their groundbreaking study, *The Impact of Publicity on Corporate Offenders*, “it is fanciful to suggest that corporate entities inherently lack the capacity to be stigmatized because they are fictitious beings, without friends and neighbors.”⁹⁰ A large corporation, thus, is analogous

⁸⁷ See Korb, note 10; Grassley, note 77; Kornhauser, note 70, at 112; Beale, note 70, at 222; Soled & Ventry, note 67, at 12A.

⁸⁸ Massaro, note 45, at 1883.

⁸⁹ See, e.g., Soled & Ventry, note 67, at 12A.

⁹⁰ Brent Fisse & John Braithwaite, *The Impact of Publicity on Corporate Offenders* 291 (1983). Other criminal law scholars contend that corporate managers may fear association with a corporation subject to a shaming sanction for engaging in acts like defrauding customers or misleading investors because, as Jayne Barnard has argued, “for top-level managers and members of their social class, fear of being shamed before their family members and peers may even exceed the fear of criminal prosecution, exposure to civil lawsuits, or other forms of officially imposed sanctions.” Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. Cal. L. Rev. 959, 967 (1999).

to a modern-day Hester Prynne,⁹¹ a well-known actor who operates within a close-knit community.

2. *Damage to Social Status*

Some commentators have suggested that, consistent with Massaro's analysis, publicity of a corporation's use of an abusive tax shelter could emit a negative signal that could result in damage to social status and communal ostracism.⁹²

By revealing a corporation's participation in an abusive tax shelter, the government could insinuate that the corporation could be engaged in deceit in *nontax* areas as well.⁹³ Economists Mihir Desai and Dhammika Dharmapala have identified a correlation between corporations that have pursued tax shelters and those that have demonstrated "obfuscatory actions" in preparing financial earnings reports.⁹⁴ It is possible that a shaming sanction for corporate tax abuse could lead a corporation's shareholders and others to suspect that the corporation's managers also are inclined to commit financial accounting fraud, to withhold material information regarding the corporation's business objectives, and to act improperly with business partners and consumers.⁹⁵

Some tax advisors have asserted that such suspicions could cause a corporation's stock price to drop, its consumers to lose confidence in its products, and private and government regulators to increase scrutiny of the corporation.⁹⁶ By contrast, when a corporation pays a

⁹¹ Nathaniel Hawthorne, *The Scarlet Letter* 51 (Bantam Books, 1988) (1850).

⁹² See, e.g., Kornhauser, note 70, at 104 ("publicity strengthens penalties because it . . . increases chances of public shaming for non-compliance"); David Lenter, Joel Slemrod & Douglas Shackelford, Public Disclosure of Corporate Tax Return Information: Accounting, Economics, and Legal Issues, 56 *Nat'l Tax J.* 803, 820 (2003) (theorizing that in response to publicity of corporate tax shelter activity, "[s]ome company officials might feel ashamed at being officers of companies revealed to be less than good corporate citizens").

⁹³ See Grassley, note 77 (linking evidence of corporate tax shelter activity to "clouded business ethics").

⁹⁴ See Mihir A. Desai & Dhammika Dharmapala, Earnings Management, Corporate Tax Shelters, and Book-Tax Alignment, 62 *Nat'l Tax J.* 169, 183-4 (2009) ("[T]ax avoidance demands obfuscatory actions that can be bundled with diversionary activities, including earnings manipulation, to advance the interests of managers rather than shareholders.").

⁹⁵ Further, inclusion on a list could cause a corporation to suffer "guilt by association" with other corporate offenders. See David A. Skeel, Jr., Shaming in Corporate Law, 149 *U. Pa. L. Rev.* 1811, 1836 (2001) (discussing lists and rosters in corporate shaming). By contrast, when a corporation pays a monetary tax penalty, it makes an isolated transfer to the Service that does not involve similar public or private grouping with other corporations.

⁹⁶ See KPMG International, *Tax in the Boardroom: A Discussion Paper* 16 (2004), available at <http://www.kpmg.com.au/aci/docs/tax-boardroom.pdf> ("naming and shaming" attacks on alleged tax avoiders can damage their reputations in the eyes of important stakeholders, which can lead to sharp short-term share price falls and the unwelcome at-

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monetary tax penalty to the Service that is protected by confidentiality laws, similar adverse reputational consequences may not occur because the corporation may not publicly disclose this event in public filings or announcements.⁹⁷

3. *Fear of Shaming Sanctions*

A final possible rationale in favor of shaming sanctions for corporate tax abuse is that this approach would satisfy one of Massaro's key factors by deterring corporate managers from pursuing tax strategies that could trigger the sanctions, as they would fear the possibility of reputational damage for the corporation and personal costs for themselves.⁹⁸ Senator Norm Coleman, for example, has commented that the proposal to require the Service to announce publicly the identities of corporate tax shelter participants can be viewed as "putting real deterrence in place."⁹⁹ Likewise, former Chief Counsel Donald Korb has commended his new approach to tax shelter settlements, where the Service publicizes the settlements, as "sending shivers down everyone's spine"¹⁰⁰ because "no one wants to be on the front cover of the Wall Street Journal"¹⁰¹ for investing in a tax shelter.

One could further speculate that if the Service were to publicize a corporation's tax shelters, a tax director might worry that management could terminate her employment as a way to signal that the source of the abusive tax activity has been severed from the organization.¹⁰² In cases of corporate financial accounting misreporting, for instance, one scholar has demonstrated that "stakeholders appear to reward restating firms that decouple themselves from the scandal in a

tion of more than one taxing authority."); Ernst & Young LLP, Tax Transparency Dynamics and Impact on Clients and Their Advisors 4 (Apr. 1, 2006), 2006 TNT 69-10 (Apr. 11, 2006), available in LEXIS, Tax Analysts File (describing fear among senior management of "being the subject of media coverage arising from a transaction, including a tax planning transaction, that might . . . inflict damage to corporate reputations and stock prices").

⁹⁷ See notes 79-80 and accompanying text.

⁹⁸ A prominent practitioner has echoed these sentiments, remarking that as potential for reputational harm grows, "pursuit of aggressive tax strategies . . . is bound to be rejected by management on the basis that it creates risk to the enterprise disproportionate to any possible benefit." Peter C. Canellos, Wachtell, Lipton, Rosen & Katz, Memorandum to Clients, More Tax Shelter Developments (Nov. 10, 2004) (on file with author).

⁹⁹ 150 Cong. Rec. S. 5191, 5216 (May 11, 2004) (statement of Sen. Coleman).

¹⁰⁰ Korb, note 10.

¹⁰¹ Donald Korb, Speech at Urban-Brookings Tax Policy Ctr. Forum on Tax Shelters (Feb. 11, 2005), transcript available at <http://www.taxpolicycenter.org/newsevents/>.

¹⁰² See *id.*

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substantive way,” such as by replacing their chief executive officers.¹⁰³ In response to the imposition of a corporate tax abuse shaming sanction, termination of the tax director could similarly allow management to declare that the offensive behavior was the act of a single individual that the corporation no longer employs.

There is some anecdotal evidence that the fear of personal costs as a result of corporate abuse publicity exists among corporate tax directors. In perhaps the greatest of ironies, the remaining national accounting firms—the organizations that fueled the tax shelter boom of the late 1990’s—now advertise “reputation risk management” services to the tax directors of major corporations.¹⁰⁴ A glossy brochure from PricewaterhouseCoopers, for instance, informs tax directors ominously,

We have collected a file of press cuttings relating to the tax affairs of companies – and this file is becoming increasingly bulky. *How will your CEO or the board react to seeing your tax affairs splashed all over the front page of a national newspaper (or even on the inside pages)?*¹⁰⁵

A subtext of this accounting firm’s pitch is that tax directors should consider steps to protect their corporations from adverse tax shelter publicity because such publicity could threaten their jobs.

III. WHY SHAMING WOULD LIKELY FAIL TO DETER CORPORATE TAX ABUSE

The theory underlying shaming as an approach to corporate tax abuse is appealing. If guaranteed public exposure of a corporation’s tax shelter activity could indeed harm its social standing and reputation within its community of shareholders, business partners, and consumers, then shaming sanctions could alter the cost-benefit analysis that tax directors perform when considering tax strategies. By threatening to subject corporations that pursue tax shelters to the will of an “uncontrolled general populace,”¹⁰⁶ in theory, shaming sanctions could empower the government to deter corporate managers in ways

¹⁰³ Jared Harris, Do Firms Do “Worse” by Doing “Bad”? Financial Misrepresentation and Subsequent Firm Performance, Academy of Mgmt. Best Conference Paper 5 (2007), available at <http://faculty.darden.virginia.edu/harrisj/pdf/Harris%202007.pdf>.

¹⁰⁴ See, e.g., PricewaterhouseCoopers LLP, Tax Risk Management (2004) (on file with author); KPMG International, note 96; Ernst & Young LLP, Tax Risk Management: The Evolving Role of Tax Directors (2004) (on file with author).

¹⁰⁵ PricewaterhouseCoopers LLP, note 104, at 8 (emphasis added).

¹⁰⁶ James Q. Whitman, What Is Wrong with Inflicting Shame Sanctions?, 107 Yale L.J. 1055, 1088 (1998).

that the exclusive use of monetary tax penalties, shielded by taxpayer confidentiality, cannot.¹⁰⁷

There are several reasons, however, to question whether shaming sanctions would actually deter corporate tax abuse. As discussed in the following Sections, consumers, investors, and business partners have not demonstrated noticeable hostility in the past toward corporations that have been involved in high-profile tax shelter cases, rational investors may even perceive a corporation's willingness to engage in tax shelters as a *positive* signal, and corporate tax directors may not suffer personal loss from publicity of their corporations' abusive tax activities. As a result, I conclude that it is unlikely that this approach would discourage corporate managers from engaging in abusive tax planning.

A. *Lack of Ostracism for Corporate Offenders*

As anthropological and sociological studies have demonstrated, to deter actors from engaging in undesirable behavior, shaming sanctions must threaten to harm their reputations within their communities.¹⁰⁸ Hester Prynne was sentenced to wear a scarlet *A* so that members of her community would witness the dramatic punishment as “taking her out of the ordinary relations with humanity, and enclosing her in a sphere by herself.”¹⁰⁹ The Puritan town leaders of Hawthorne's famous story sought to impose a punishment that would cause Prynne to experience visible isolation from her community and, in turn, deter others from emulating her behavior. Without the threat of reputational harm and visible communal ostracism, a shaming sanction would be a poor deterrent.

Past uses of shaming sanctions in tax enforcement appear to have instilled fear of reputational harm in the minds of many delinquent taxpayers. State revenue agencies report that their shaming websites have been successful because taxpayers fear that communal ostracism could follow publicity of their tax delinquencies.¹¹⁰ According to

¹⁰⁷ Id. at 1063.

¹⁰⁸ See Massaro, note 45.

¹⁰⁹ Hawthorne, note 91, at 51.

¹¹⁰ See Tom Herman, *Deadbeats Risk Cybershame, States Use Threats of Public Disgrace to Collect Taxes*, Wall St. J., June 27, 2007, at D2 (quoting California Franchise Tax Board spokesman as concluding, “When we studied other states' programs, we discovered it's the notice indicating your name could appear on the Web that brings in the lion's share of cash. . . . People are paying their delinquencies to avoid the embarrassment of having their name publicly listed.”); Press Release, Div. of Revenue, Dep't of Finance, State of Del., *Online List of Delinquent Delaware Taxpayers Paying Off* (Sept. 6, 2007), available at http://revenue.delaware.gov/services/press/07_release_onlinesuccess.pdf (quoting Delaware representative who sponsored legislation creating the program as concluding that the “social pressure” from public posting of the names of delinquent taxpayers “was worth the

these officials, the mere *threat* of shaming sanctions often leads delinquent taxpayers, whose whereabouts had previously been a mystery, to pay some of their outstanding tax liability.¹¹¹ As one state revenue representative described this reaction from previously delinquent taxpayers, “once their minister, their next door neighbor, brother, friends, all of them know about [their unpaid taxes], they’re much more amenable to paying what they owe.”¹¹²

Proponents of extending shaming sanctions to corporate tax participants imply that publicity of a corporation’s use of tax shelters could result in similar reputational harm to the corporation.¹¹³ As I discuss below, however, there is little evidence to suggest that publicity of a corporation’s abusive tax activity actually would cause it to suffer reputational harm. Rather, past community reaction to media reports that particular corporations had engaged in tax shelters implies that shaming sanctions for corporate tax abuse may not pose credible threats to the social standing and reputations of corporations.

1. *Past Community Reaction*

In past cases where shareholders, consumers, and business partners have learned that a corporation reduced its federal taxes by using a tax shelter, the corporation did not suffer visible communal ostracism. This result stands in stark contrast to the community reaction that has followed publicity of taxpayers’ failures to pay their outstanding taxes or file their tax returns.

Upon learning that a particular corporation used aggressive tax strategies to claim tax benefits, shareholders, consumers, and employees have not shunned the corporation for displaying, in Senator Grassley’s words, “clouded business ethics.”¹¹⁴ There are no reports, for example, that when Black & Decker’s litigation with the federal government revealed that the corporation had used the contingent lia-

effort” and the “success of this program has been outstanding”); Wyatt, note 59 (quoting South Carolina Department of Revenue official as stating that “to have your neighbors be able to see your [tax] debt, that would be embarrassing of course, and that’s the whole idea”).

¹¹¹ Lydia Quarles, *Recouping Delinquent Taxes: Does “Shame” Work?*, Tech. Brief (Stennis Inst. of Gov’t., Miss. State Univ.), Mar., 2007, at 1-2, available at <http://www.sig.msstate.edu/modules/cms/images/thumb/169.pdf> (reporting that in Wisconsin, in the time between its mailing of warning letters to delinquent taxpayers and the first use of the Website of Shame, less than two months, over 900 delinquent taxpayers agreed to pay an aggregate of more than \$8 million in outstanding tax liability).

¹¹² Wyatt, note 59 (quoting spokesman for Louisiana Department of Revenue).

¹¹³ See, e.g., Soled & Ventry, note 67. Indeed, the authors have advocated simultaneously for the implementation of a shaming program for tax delinquents at the federal level. See *id.*

¹¹⁴ Grassley, note 77.

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bility tax shelter to reduce its federal taxes, the corporation's stock price plunged dramatically or that shareholders demanded management resignations or that any consumer, even the most tax knowledgeable, opted against purchasing a DustBuster in protest of its maker.¹¹⁵

Michelle Hanlon and Joel Slemrod recently found that tax shelter publicity does not lead to drops in the corporation's stock price as significant as those following public reports of financial accounting fraud.¹¹⁶ Hanlon and Slemrod also found that "firms with relatively high disclosed cash effective tax rates have a less negative [stock price] reaction, consistent with the market reacting positively to evidence that these firms were not as 'tax-passive' as previously believed."¹¹⁷ Put differently, the market may interpret news of tax shelter activity by a corporation with a high effective tax rate as a "positive signal of tax aggressiveness."¹¹⁸ Similarly, another commentator has noted that on the day that the U.S. Tax Court affirmed that Colgate-Palmolive had engaged in a tax shelter, Colgate-Palmolive's stock price *rose* and continued to rise throughout the next week.¹¹⁹

Future and current shareholders of a corporation may view its participation in tax shelters very differently from instances in which the corporation fails to disclose pertinent details about its business plan or engages in deceptive financial accounting practices. As journalist Alan Murray once wrote, "Lying to the IRS doesn't generate the same public outrage as lying to shareholders."¹²⁰ When a corporation withholds important information from its shareholders that may enable them to value and make investment decisions regarding their stock in the corporation, shareholders may criticize the corporation's managers as directly threatening their economic interests. By contrast, outwitting the Service may be interpreted as *furthering* shareholders' interests.

The high reputational cost that policymakers have implied would accompany a shaming sanction for corporate tax abuse would be unlikely to materialize in practice. Although managers may fear that tax

¹¹⁵ For discussion of public reaction to Black & Decker's legal victory, see Marie Leone, Courts and Torts: Tax-Shelter Shocker, CFO.com, Dec. 21, 2004, available at <http://www.cfo.com/printable/article.cfm/3515229>.

¹¹⁶ Michelle Hanlon & Joel Slemrod, What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News About Tax Shelter Involvement, 93 J. Pub. Econ. 126, 128 (2009).

¹¹⁷ *Id.* at 127.

¹¹⁸ *Id.* at 139.

¹¹⁹ Jonathan M. Prokup, Down with Disclosure, 8 J. Tax Prac. & Proc. 27, 31 (Apr.-May 2006).

¹²⁰ Alan Murray, Inflated Profits in Corporate Books Is Half the Story, Wall St. J., July 2, 2002, at A4.

shelter publicity would impose reputational costs on their corporations, if past community reaction is an accurate guide, this fear seems to be exaggerated. If shaming sanctions were implemented, it is probable that corporate managers would quickly recognize the lack of reputational risk the sanctions pose to their corporations. Consequently, the value of the adverse reputational cost from tax shelter publicity would probably be too small to deter rational managers from pursuing aggressive tax positions.

2. *Possible Explanations*

Why have corporations not suffered greater drops in stock price, consumer backlash, and criticism from business partners in response to public reports that they have utilized tax shelters to reduce their tax burden? Below, I consider several possible explanations.

No Observable Social Harm. Perhaps community members do not express moral outrage upon hearing news of corporations' use of tax shelters because they cannot readily observe the social harm that this activity causes. When a corporation spills oily wastewater into a lake or knowingly distributes toxic toothpaste, interest groups quickly mobilize the community to boycott the corporation's products and call for the government to levy hefty monetary sanctions.¹²¹ The community may respond differently to publicity of corporate tax abuse because the activity does not appear to create social harm as visible as other types of corporate malfeasance.

This explanation, however, is unpersuasive. Individuals operate within household budget constraints and probably understand that the government does as well. When a corporation employs a tax shelter to reduce its tax payments in ways that Congress never anticipated, the government may be forced to raise tax rates on all other taxpayers.¹²² It would be naïve to assume that laypeople cannot understand the connection between corporate tax abuse and the government's budgetary constraints.

Politicians who rally against corporate tax abuse frequently highlight this connection. While introducing the legislation that would have required the Service to publicize the names of corporate tax shelter participants, Senator Norm Coleman, for example, commented of

¹²¹ See Taryn Fuchs-Burnett, *Mass Public Corporate Apology*, 57 *Disp. Resol. J.* 26, 31-32 (May-July 2002) (describing public reaction to Exxon, United Airlines, and Firestone harms).

¹²² 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, 388 (2002) ("Congress did not set current tax rates with the expectation that tax liability would be artificially reduced through the use of tax shelters.").

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corporate tax abuse, “[t]his is not a victimless crime. It is not the Government that loses the money. It is the people of America, average working families who will bear the brunt of lost revenue . . .”¹²³ Senator Charles Grassley has further implied that corporate tax abuse is unpatriotic because it may deprive the government of funds needed to protect itself, stating,

Now here you have 3,000 Americans killed on September 11 . . . Then you have these big accounting firms marketing these tax shelters. . .telling people: You are going to forget all about that when you see your new earnings report. Corporations like that ought to get their heart into America or get their rear end out because what this country is all about is pulling together, particularly now in time of war.¹²⁴

Such frequent public discussion of the effects of corporate tax abuse on tax rates and the funding of important federal programs weakens the claim that the community is unaware of the social harm that this activity causes. The lack of observable social harm, therefore, does not adequately explain why members of corporations’ communities do not ostracize corporations that pursue tax shelters.

Subject Matter Disinterest. Another possible explanation for the community’s lack of hostility toward corporate tax shelter participants is that consumers, investors, and business partners are simply uninterested in the subject matter. Corporate tax shelters are incredibly complex by design¹²⁵ and so it is understandable that news of a large corporation’s tax shelter might attract the attention of only tax lawyers and accountants. Compared to images of slicked ducklings navigating a corporation’s oil spill or reports of toddlers injured by defective toy trains, corporate tax abuse may fail to capture the community’s attention. As a result, some may argue, tax shelter publicity results in apathy from members of corporations’ communities.

This explanation for the community’s lack of hostility toward corporate tax shelter participants is also unpersuasive. Since the peak of the tax shelter boom in the late 1990’s, there has been marked public interest in this topic. Popular newspapers and periodicals have published prominent reports on the specific details of high-profile

¹²³ 150 Cong. Rec. S. 5191, 5216 (May 11, 2004) (statement of Sen. Coleman).

¹²⁴ 150 Cong. Rec. S. 4737, 4740 (May 3, 2004) (statement of Sen. Grassley).

¹²⁵ See Peter C. Canellos, A Tax Practitioner’s Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters, 54 SMU L. Rev. 47, 49 (2001) (“In [tax shelter] transactions, an elaborate series of formal steps is contrived to lead to an unreasonably beneficial tax result, usually resulting from some defect or ambiguity in the tax law.”)

corporate tax shelters.¹²⁶ David Cay Johnston's exposé of corporate tax shelters and other forms of tax avoidance, *Perfectly Legal*,¹²⁷ quickly became a *New York Times* best seller.¹²⁸ Several television programs, such as PBS's *Frontline* and MSNBC's *The Rachel Maddow Show*, have featured in-depth programs explaining the details of corporate tax abuse¹²⁹ in terms that are "understandable and relevant to a general audience."¹³⁰ The explanation that the community fails to react negatively to corporations that pursue tax shelters as a result of disinterest in this topic, therefore, is also unconvincing.

Violations of Tax Standards, Not Tax Rules. A promising explanation for the absence of communal ostracism in response to corporate tax abuse publicity is that the community of consumers, shareholders, and business partners do not view tax avoidance activities that fail to violate explicit tax rules as inconsistent with shared moral norms. By contrast, when the community perceives that a taxpayer has violated a clear tax rule in place at the time of the taxpayer's action, it may react to this perception with significantly more hostility.

The community appears to perceive tax planning, whether by individuals or corporations, as a game in which the objective is to claim tax positions that yield the greatest tax benefits without breaching any explicit tax rules.¹³¹ If a taxpayer claims a tax position that is not prohibited by tax rules and the taxing authority does not challenge the taxpayer's position, the community appears to view the taxpayer as winning the tax planning game. If the taxing authority, however, reviews the taxpayer's tax position and determines that it fails to satisfy tax standards such as the economic substance doctrine, the community may view the taxpayer as losing the tax planning game, but at least as having played it fairly.

¹²⁶ The general public has learned about corporate tax shelters from newspapers as varied as *The Wall Street Journal* and *The New York Post*. See, e.g., Jonathan Weil, Ernst & Young Faces Tax-Shelter Inquiry, *Wall St. J.*, May 24, 2004 at C1; Janet Whitman, Feds Hit E&Y 4 in Tax Shelter Fraud, *N.Y. Post*, May 31, 2007, at 40.

¹²⁷ David Cay Johnston, *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich-and Cheat Everybody Else* (2003).

¹²⁸ *The New York Times Best Seller List—March 21, 2004*, *N.Y. Times*, Mar. 21, 2004, at 18.

¹²⁹ *Frontline: Tax Me if You Can* (PBS television broadcast Feb. 19, 2003), transcript available at <http://www.pbs.org/wgbh/pages/frontline/>; *The Rachel Maddow Show*, Interview with Austan Goolsbee (MSNBC television broadcast May 4, 2009), transcript available at <http://www.msnbc.msn.com/id/30641410/>.

¹³⁰ Hedrick Smith, *Frontline: Tax Me If You Can*, [washingtonpost.com](http://www.washingtonpost.com) (Feb. 20, 2004), available at <http://www.washingtonpost.com/ac2/wp-dyn/A38516-2003Dec29?language=printer> (online discussion with producer of documentary).

¹³¹ I thank Deborah Schenk for helpful discussion of this point. Reporters in the popular press frequently refer to the problem of corporate tax abuse as a "game." See, e.g., Mike France, *The Rise of the Wall Street Tax Machine*, *Bus. Wk.*, Mar. 31, 2003, at 84 (containing references to the "shelter game").

This analogy helps to explain the community's past reaction to news that particular corporations have engaged in tax shelters. In newspaper articles and editorials describing the tax shelters of well-known corporations, reporters often refer to the corporations' exploitation of "loopholes" in the corporate tax law.¹³² This characterization of corporate tax abuse implies that the community recognizes that corporations do not violate clear tax rules when they engage in tax shelters. Instead, the community seems to recognize that a corporation has taken advantage of a particular reading of the Code with which the Service or Congress disagrees after the fact. A "loophole," after all, is "an ambiguity or omission in the text through which the intent of a statute, contract, or obligation may be evaded."¹³³ Because corporations do not violate explicit tax rules when they claim tax benefits that take advantage of such an "ambiguity or omission" in the corporate tax law, the community may not consider typical occurrences of corporate tax abuse as worthy of moral condemnation.

On the other hand, when a taxpayer violates an explicit tax rule, such as the legal obligation to pay outstanding tax liability or the requirement to file a federal income tax return,¹³⁴ the community may not consider the taxpayer as having played the tax planning game fairly at all. For example, the community may react harshly toward an individual or local business when its name appears on a state's tax delinquency shaming website, in part because the community considers the taxpayer to have flagrantly ignored a clear tax rule requiring it to pay assessed state taxes on time. When the Wisconsin State Journal, for example, described delinquent taxpayers appearing on the state's Website of Shame as "scofflaws," it used that term to refer implicitly to the rule-based nature of the taxpayers' offense.¹³⁵ A "scofflaw" literally is "a contemptuous lawbreaker."¹³⁶

¹³² See, e.g., William M. Bulkeley, IBM's Under-the-Wire Tax Break, *Wall St. J.*, June 7, 2007, at A3 (referring to IBM's use of aggressive tax structure as "loophole").

¹³³ Webster's Third New International Dictionary 1335 (1961).

¹³⁴ IRC § 6072(a).

¹³⁵ See Editorial, *Wis. St. J.*, Keep Pressure on Tax Scofflaws, Dec. 27, 2006, at A8, available at <http://www.accessmylibrary.com/article-1G1-156443859/editorial-keep-pressure-tax.html>. Similar communal reaction often follows news that an elected or appointed political official has failed to file tax returns or pay delinquent taxes. For example, in 2008, Charles O'Byrne, a top aide to New York Governor David Paterson, explained his failure to pay hundreds of thousands of dollars in outstanding tax liability as resulting from "late-filing syndrome." See Nicholas Confessore & Jeremy W. Peters, Governor's Aide Had "Late-Filing Syndrome," *Lawyer Says*, *N.Y. Times*, Oct. 22, 2008, at A27. In response to O'Byrne's public explanation, the *New York Post* published an editorial, in which its editorial board stated "Maybe [Governor] Paterson trusts him. But there is no reason for the rest of New York to do so. Not at all. How long before that distrust rubs off on Paterson?" Editorial, *N.Y. Post*, Taxing Credibility, Oct. 23, 2008, at 36.

¹³⁶ Webster's, note 133, at 2034.

Revenue agencies in states that have adopted shaming websites have acknowledged the importance of emphasizing to the community that individual and business taxpayers that are subject to shaming sanctions have failed to abide by a clear obligation to pay state taxes on time by explaining on their websites that the taxpayers featured have ignored multiple warnings to pay outstanding tax liability and that none of them is attempting to satisfy a portion of the outstanding liability.¹³⁷ One state revenue official has theorized that state tax delinquency shaming websites are effective because the community understands that featured taxpayers “just flat out owe us the money and won’t pay it!”¹³⁸

If the government were to attempt to shame corporations publicly for participating in tax shelters that were not explicitly prohibited in advance by clear statutory tax rules, corporations would likely deflect communal ostracism by highlighting for the community the distinction between corporate tax abuse and acts that represent clear violations of tax rules. For example, if shaming sanctions were in effect at the time that Black & Decker pursued its contingent liability transaction, a tax strategy that was not explicitly prohibited in advance,¹³⁹ Black & Decker could have turned to a number of options to deflect community outrage, if any, that a shaming sanction for this activity might produce. Black & Decker’s management, for example, could have issued a press release making a statement such as the following: “While the Service has determined that Black & Decker has claimed tax benefits that were inappropriate, Black & Decker violated no law in the Code or elsewhere at the time it filed its tax return.”

Such statements could persuade the community that Black & Decker simply played the tax planning game and lost, but that it was not the type of corporation that would intentionally cheat at the tax planning game by ignoring clear tax rules. In 2007, the Blackstone Group, for example, issued a similar press release in response to a front-page article in *The New York Times* that implied that its tax treatment of its initial public offering was abusive.¹⁴⁰

A potential response to this analysis is that if the government were to implement shaming sanctions against corporations that have pur-

¹³⁷ See, e.g., Wisconsin Dep’t of Revenue, note 54.

¹³⁸ See Steven Walters, *A New Weapon Against Tax Dodgers: Shame*, Mil. J. Sentinel, Dec. 18, 2003, at 01A (quoting spokesman for Louisiana Department of Revenue).

¹³⁹ See note 20 and accompanying text.

¹⁴⁰ Press Release, The Blackstone Group, *Blackstone Says The New York Times Inaccurate and Misleading* (July 13, 2007), available at http://www.blackstone.com/news/press_releases/07-13-2007.pdf (“Blackstone is not in any way taking advantage of tax loopholes, but rather is using a standard tax method used widely by private and public companies when business assets are sold.”).

sued abusive tax shelters, the community's perception of this activity would change. Put differently, shaming would "legitimate,"¹⁴¹ in the eyes of the community, the government's claim that corporate tax abuse is socially harmful. This argument is questionable for two reasons. First, to explain clearly the government's position regarding corporate tax shelters to the community, a massive public education campaign would be needed regarding the applicable judicial tax standards, such as the economic substance and business purpose doctrines. Such a broad education campaign has not yet occurred. Second, despite the logical attractiveness of the response that shaming sanctions may change perceptions of corporate tax abuse, sociologists and legal scholars have yet to confirm that shaming sanctions or legal institutions are capable of creating or changing shared moral norms.¹⁴²

In light of the community's perception of corporate tax shelters as legitimate moves in the game of tax planning, its potential for expressing moral outrage toward corporations that would be subject to shaming sanctions would likely be limited.

B. Positive Signal

In addition to failing to provoke communal ostracism, a shaming sanction for corporate tax abuse could have the ironic effect of emitting a *positive* signal to key members of the corporation's community—investors. As I discuss below, shaming sanctions for corporate tax abuse could signal to the investing community that the shamed corporation has a tax director who is willing to "push the envelope" by claiming tax benefits for his corporation that rely on strict constructionist interpretations of the tax rules in the Code. Investors could consider this behavior to be an attractive attribute of a corporation because it could increase the economic return on their investments in the corporation's stock. The potentially positive signal that a shaming sanction for corporate tax abuse could release further diminishes the potential ability of this sanction to deter corporate managers from pursuing abusive tax shelters.

¹⁴¹ See Alan Hyde, *The Concept of Legitimation in the Sociology of Law*, 1983 Wis. L. Rev. 2379, for criticism of the theory of "legitimation."

¹⁴² See *id.* ("[S]tudies show that the public has little awareness of courts, thinks poorly of the few judicial decisions of which it has knowledge, and, most importantly, cares much more about the substantive value of a legal decision than its legal form or pedigree. As a result it is difficult to support the idea that legal behavior contributes to public obedience irrespective of the substantive norms advanced.")

1. *Pushing the Envelope*

A shaming sanction for corporate tax abuse would emit a very different signal to investors than a shaming sanction for a violation of an explicit tax rule. Publicity that a corporation failed to pay its taxes, file its tax return, or disclose specifically requested information to the Service would likely send negative signals to investors. If a corporation had blatantly violated tax rules requiring it to file a tax return or provide certain documents to the Service, investors could be concerned that the corporation also may fail to comply with rules that require it to deliver pertinent information to them, such as accurate earnings reports and detailed information about future business plans. Alternatively, investors could view a corporation that does not follow explicit tax rules as an unorganized operation with incompetent managers.

If the Service were to publicize that it had settled with a large corporation as a result of its participation in an abusive tax shelter or require the corporation to publicize its payment of monetary tax shelter penalties, investors would understand that the corporation would not be entitled to claim tax benefits using the particular transaction that triggered the shaming sanction. Yet at the same time, the shaming sanction could signal that this corporation's tax director was willing to claim risky tax positions that could generate substantial benefits for investors in the future. As a result of the tax director's willingness to rely on hyper-technical readings of the Code to achieve these results, a shaming sanction could bear closer resemblance to a "red badge of courage"¹⁴³ than to a "scarlet letter."¹⁴⁴

Investors often comment that they do not seek to invest in corporations whose tax directors break the tax law, but rather that claim tax positions that "push the envelope."¹⁴⁵ Much like a test pilot performs aeronautical maneuvers that barely avoid crossing critical safety thresholds, when a tax director pushes the envelope, he claims tax positions that technically appear to comply with the tax rules of the Code. Investors may respect this type of tax director for pursuing aggressive tax positions that yield economic returns on their investments, but refrain from violating explicit tax rules.

What type of investors might be attracted to corporations whose tax directors claim abusive tax positions? Investors who are most con-

¹⁴³ Stephen Crane, *The Red Badge of Courage* (Prestwick House, 2004) (1895).

¹⁴⁴ Hawthorne, note 91.

¹⁴⁵ See Nanette Byrnes & Louis Lavelle, *The Corporate Tax Game*, *Bus. Wk.*, Mar. 31, 2003, at 78 (discussing corporate tax directors' "willingness to push the envelope"). Best-selling author Tom Wolfe first introduced this term to the general public. See Tom Wolfe, *The Right Stuff* 8 (1979).

cerned with their short-term economic return from owning a corporation's stock may be especially interested in discovering which corporations have aggressive tax directors. Hedge funds and private equity funds, for example, have purchased significant stakes in the stock of blue chip corporations.¹⁴⁶ Many of these funds seek to maximize the economic return on their investment within a relatively short period of time¹⁴⁷ and may not be concerned that a corporation participates in a transaction that the Service subsequently rejects as a tax shelter. These short-term investors may enjoy a corporation's claimed tax benefits today; years later, when the Service audits and rejects the corporation's tax position, they no longer own stock in the corporation.¹⁴⁸

The use of shaming sanctions for corporate tax abuse could supply these short-term investors with an unintended, but valuable roadmap. Hedge fund and private equity fund managers spend significant time searching for information about corporate managers' tax planning behavior, insight that may not be readily apparent to the market.¹⁴⁹ During my research, one manager of a multi-billion hedge fund commented to me that "it can be a plus if a public company's tax director takes risks. Learning whether a company has a risk-taking tax director plays a role in analyzing the investment."¹⁵⁰ Another prominent fund manager explained, "it would be beneficial if we had a way to find companies whose tax directors and lawyers are at the cutting edge of tax management."¹⁵¹

Tax directors may discount any reputational harm of tax shelter publicity to their corporations as a result of the positive reaction of short-term investors like hedge and private equity firms in response to this information. The potentially positive signal of shaming sanctions for corporate tax abuse, therefore, may further diminish the deterrence value of this form of punishment.

2. *Increased Economic Returns*

Several factors explain why investors may have a favorable reaction to news that a corporation engages in aggressive tax strategies.

¹⁴⁶ See Mara Der Hovanesian, *Attack of the Hungry Hedge Funds*, *Bus. Wk.*, Feb. 20, 2006, at 72 (discussing hedge fund investment in blue chip corporations).

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*; see also Ananth Madhavan, *Implementation of Hedge Fund Strategies*, in *Hedge Fund Strategies*, A Global Outlook 74 (2002).

¹⁵⁰ Interview with Hedge Fund A Manager (Jan. 28, 2007).

¹⁵¹ Interview with Hedge Fund B Manager (Jan. 29, 2007).

At the most basic level, aggressive tax strategies enable a corporation to drive down its effective tax rate.¹⁵² While the top federal statutory corporate tax rate is 35%,¹⁵³ most corporations strive to pay a much lower effective tax rate.¹⁵⁴ A reduced corporate tax burden may enable a corporation to pursue business ventures that corporations with higher effective tax rates may not be able to afford. A reduced effective tax rate may also enable a corporation to distribute dividends to shareholders and still fund its operations.¹⁵⁵

A corporation's effective tax rate also plays a significant role in the market's valuation of the corporation and its stock.¹⁵⁶ If a corporation can engage in tax shelters, it can enjoy tax losses that reduce its taxable income, but that do not actually result in real economic losses. As a result, the corporation's "book income" for financial accounting purposes, as well as its calculation of financial earnings of the corporation per share of its outstanding stock, will remain steady. The earnings per share figure for any public corporation is considered a measure of the corporation's profitability and directly affects the price of the corporation's stock.¹⁵⁷

Aggressive tax strategies also enable a corporation to borrow less money from third-party lenders in order to finance operations. If a corporation can pursue an aggressive tax strategy successfully, it can use the value of the tax benefits in place of borrowed cash.¹⁵⁸ A 2006 study by John Graham and Alan Tucker confirmed that the corporations involved in the major tax shelter cases over the last decade borrowed significantly less money than other corporations.¹⁵⁹ According to the study, if the corporations that used tax shelters had instead attempted to borrow funds from third-party lenders, the borrowings would have required corporations to borrow such large amounts that their debt ratios would have approached 90% of their asset values, "an unheard-of number."¹⁶⁰ Tax shelter activity enables a corporation

¹⁵² See Treasury Dep't, note 1, at 14.

¹⁵³ IRC § 11(a).

¹⁵⁴ See Treasury Dep't, note 1, at 14.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ The "earnings per share" figure is calculated by dividing the net earnings of a corporation by the average number of shares of its common stock outstanding during a particular period.

¹⁵⁸ See John R. Graham & Alan L. Tucker, *Tax Shelters and Corporate Debt Policy*, 81 *J. Fin. Econ.* 563, 563 (2006) (concluding that firms in sample "use less debt when they engage in tax sheltering").

¹⁵⁹ *Id.* at 563 ("Compared to companies with similar pre-shelter debt ratios, the debt ratios of firms engaged in tax shelters fall by about 8%.").

¹⁶⁰ Press Release, Duke University, *New Study Sheds Light on Corporate Tax Shelters* (Dec. 20, 2004), available at <http://www.pace.edu/News/read.cfm?forum=9&id=422&thread=361>.

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to finance operations in ways that may not adversely affect its credit rating from third-party ratings agencies or otherwise cause it to appear credit risky to investors.¹⁶¹

A shaming sanction for corporate tax abuse, thus, would reveal to investors that a corporation may have a tax director who may engage in tax strategies that reduce the corporation's effective tax rate and enable the corporation to avoid excessive third-party borrowing.

C. *Low Risk of Personal Loss*

It is possible that tax directors could be deterred by the threat of shaming sanctions because they would worry that they could suffer personal loss if their corporations' abusive tax activities were exposed publicly. In recent years, the federal government has successfully pursued criminal tax evasion charges against accountants and tax lawyers who marketed abusive tax shelters to corporations.¹⁶² When considering these developments, an understandable inference may be that tax directors may fear that tax shelter publicity resulting from a shaming sanction could lead senior management to terminate their employment as a way to absolve the corporations publicly of tax shelter involvement.

Despite the possibility that some tax directors may perceive that they would suffer personal losses if their corporations' abusive tax activities were revealed publicly, the justification for this anxiety is weak. First, in contrast to the adverse consequences that individual *promoters* of corporate tax abuse have recently faced as a result of criminal prosecution, individual *users* of tax shelter products do not appear to have suffered similar consequences as a result of tax shelter publicity. Second, as noted above, by the time the Service discovers a corporation's participation in a tax shelter, the tax director that originally authorized it may no longer be affiliated with the corporation.

Accordingly, although some tax directors could become apprehensive over the threat of shaming sanctions for corporate tax abuse in the short term, over time, they should realize that they have little to fear from tax shelter publicity.

¹⁶¹ When determining a corporation's creditworthiness, bond ratings agencies consider the amount of debt for which a corporation is liable. See, e.g., Standard & Poor's, Corporate Ratings Criteria 2006, at 45-60 (2006), available at http://www2.standardandpoors.com/spf/pdf/products/corporateratings_2006_corp.pdf.

¹⁶² In 2008, a federal jury convicted two KPMG accountants and a former tax lawyer from a major New York law firm of criminal tax evasion charges stemming from the marketing of abusive tax shelter products. See Lynnley Browning, 3 Convicted in KPMG Tax Shelter Case, N.Y. Times, Dec. 18, 2008, at B11. In 2005, KPMG itself avoided criminal prosecution for tax shelter activities by entering into a \$456 million settlement agreement with the federal government. *Id.*

1. *Past Professional Consequences*

In contrast to the termination of chief executive officers and other corporate managers following news of financial accounting misreporting,¹⁶³ there is an absence of evidence of similar treatment of tax directors that authorized tax strategies that the Service or courts rejected as abusive tax shelters.

It is even possible that some employers may be attracted to hiring tax professionals who have demonstrated a willingness to engage in aggressive tax planning. A tax director's association with a corporation that has pursued tax shelters is unlikely to taint his professional reputation, and indeed, could even enhance it. For example, despite the publicity of Enron's abusive financial and tax accounting practices in the late 1990's, other banks and trading firms have actively sought to hire the individuals who were employed by Enron.¹⁶⁴ Market insiders have described employers' attraction to individuals who engaged in such aggressive behavior on behalf of their former company as the "Enron mystique."¹⁶⁵

Corporate tax abuse is distinct from tax shelter activity that benefits individual managers personally. When Sprint executives authorized a tax shelter that allowed them to defer their *personal* tax liability on over \$200 million of income resulting from the exercise of options, for instance, the board of directors questioned the motivation for their acts.¹⁶⁶ Despite the executives' contention to the contrary,¹⁶⁷ the Sprint board of directors viewed these executives as subjecting the corporation to adverse publicity without providing real tax benefits to the corporation. As a result, the board forced the two executives to resign.¹⁶⁸ If the primary purpose of this tax shelter had been to benefit Sprint rather than the individuals who authorized it, on the other hand, perhaps the executives would not have suffered such professional consequences.

¹⁶³ See Harris, note 103, at 5.

¹⁶⁴ See Ann Davis, Trading on the Enron Mystique; Veterans Flourish, Capitalizing on Links to Innovative Giant, Wall St. J., Nov. 14, 2006, at C1.

¹⁶⁵ *Id.*

¹⁶⁶ See Rebecca Blumenstein, Sprint Forced Out Top Executives over Questionable Tax Shelter, Wall St. J., Feb. 5, 2003, at A1.

¹⁶⁷ See *id.* The executives' rationale was that if they had been required to pay tax on the income resulting from their stock option exercises, they might have had to sell some of the Sprint shares in order to settle their hefty tax bills. Sales of Sprint stock by the leaders of the company, they argued, could harm the stock market's confidence in Sprint and result in a decrease in the market value of all Sprint stock. *Id.*

¹⁶⁸ See David Cay Johnston, I.R.S. Takes Aim at Big Shelters and Hopes Message Filters Down, N.Y. Times, July 6, 2003, at A1 (describing Sprint management resignations).

2. *Tax Shelter Time Lag*

Another reason to question the potential for shaming sanctions to cause tax directors to alter their behavior as a result of concern for personal consequences is that the Service may not discover a corporation's tax shelter until significant time has elapsed from the tax year when the corporation used it to claim tax benefits.¹⁶⁹ This result may be the case even when a corporation described the details of the tax position on its tax return and complied with the Service's vast disclosure requirements. In the case of Black & Decker's contingent liability tax shelter, for example, six years passed from the year in which the corporation claimed its large tax loss and the year when the Service challenged the loss in a notice of deficiency.¹⁷⁰ As former Commissioner of Internal Revenue Charles Rossotti once remarked to his audit teams, "You're not in the audit business. You're in the archeology business."¹⁷¹

The primary obstacle that auditors face in their search for tax shelters is that they do not necessarily know what they are looking for in advance. When a taxpayer simply fails to file a tax return or pay assessed taxes that are due and undisputed, the taxing authority can quickly detect this act of noncompliance with clear tax rules (as long as it is aware of the taxpayer's existence). The typical corporate tax shelter, by contrast, may not be readily apparent to auditors because it may appear to be an ordinary business transaction that complies with the literal tax rules of the Code. Auditors, accordingly, must unearth significant factual information about a particular tax position before they can determine whether it satisfies tax standards like the economic substance or business purpose requirements.¹⁷² Further, the Service's practice of requesting that large corporations voluntarily extend the relevant statute of limitations only exacerbates the tax shelter time lag.¹⁷³ And in cases where a corporation does not disclose its

¹⁶⁹ See Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 *Yale J. on Reg.* 77, 87 (2006) (commenting on the "lengthy time lag" between the execution of a tax shelter and its eventual detection by the Service).

¹⁷⁰ *Black & Decker Corp. v. United States*, 340 F. Supp.2d 621, 622-23 (D. Md. 2004).

¹⁷¹ David Cay Johnston, *Agents Say Fast Audits Hurt I.R.S.*, *N.Y. Times*, Jan. 12, 2007, at C6 (quoting former IRS Commissioner Charles Rossotti).

¹⁷² See Cliff Jernigan, *Corporate Tax Audit Survival* 79-84 (2005) (describing audit process for large corporations).

¹⁷³ See *id.* Suggestions that the Service "speed up" audits of large corporations have faced a barrage of criticism from current and former IRS officials. See Jonathan Weisman, *IRS Speeds Corporate Tax Audits*, *Wash. Post*, Dec. 29, 2003, at A1. These officials claim that a strategy of accelerated audits could cause IRS auditors to "miss tax dodges and fail to explore suspicious transactions." *Id.* (quoting former IRS Chief Counsel B. John Williams, Jr.). Some tax shelter time lag, thus, appears to be inevitable.

participation in a listed transaction, the statute of limitations may *never* expire.¹⁷⁴

The considerable tax shelter time lag could dramatically reduce, if not eliminate, concerns of tax directors that shaming sanctions could cause them to suffer indirect personal loss. To appreciate this effect of the tax shelter time lag, consider the following example: Assume the Service is required by law to publicize, using its website and other media, any instance in which a corporation pays a monetary tax penalty to the Service for engaging in a transaction that lacks economic substance (a tax shelter). The tax director of *Blue Chip Co.*, a Fortune 500 corporation, is considering entering an extremely aggressive tax strategy with a code name of “LOOT” (“Low Odds of Tax”)¹⁷⁵ that would enable *Blue Chip Co.* to offset hundreds of millions of dollars of taxable corporate income with a large current tax deduction. Because the LOOT tax strategy appears to comply with the literal words of the Code and does not violate any administrative prohibitions, assume that the Service would not detect *Blue Chip Co.*’s use of LOOT, levy a tax shelter penalty against *Blue Chip Co.*, and then publicize this event until at least seven years have elapsed.

For *Blue Chip Co.*’s tax director, the time lag could reduce concern that he would suffer personal consequences by authorizing the use of the tax strategy. In the intervening seven years before the Service’s imposition of a shaming sanction against *Blue Chip Co.* for its use of LOOT, *Blue Chip Co.*’s tax director could retire or transition to another corporation. The tax shelter time lag makes it unlikely that this tax director would lose his job in response to adverse publicity resulting from a shaming sanction. The potential for the Service to subject *Blue Chip Co.* to a shaming sanction for engaging in abusive tax activity, therefore, should not deter its tax director from the pursuit of LOOT.

IV. HOW SHAMING COULD WEAKEN TAX COMPLIANCE

Shaming sanctions, as I have argued, would be unlikely to deter corporate managers from pursuing abusive tax shelters. Admittedly, my analysis depends on future predictions of behavior, using past responses to tax shelter publicity and the application of shaming sanc-

¹⁷⁴ IRC § 6501(c)(10).

¹⁷⁵ Many of the tax shelters that accounting firms and others have promoted have similar code names, such as “COBRA,” an acronym for “Currency Options Bring Reward Alternatives.” See U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Hearings Before the Permanent Subcomm. on Investigations of the S. Comm. on Governmental Affairs, 108th Cong. 286, 8 (2003), available at <http://www.quatloos.com/TAXSHELTERREPORTFINAL.pdf>.

tions in other tax contexts as a guide. As a result, it is possible that one could conclude that there would be no harm in merely experimenting with shaming sanctions to measure their deterrence capabilities.

The defects of applying shaming sanctions in the context of corporate tax abuse, however, are not limited to their inefficacy. In addition to failing to achieve deterrence objectives, the use of shaming sanctions also could result in several unintended consequences. As I discuss in the following Section, the use of shaming sanctions against corporations that pursue tax shelters could cause conservative tax directors to perceive that abusive tax planning is rampant and, in turn, could incentivize them to claim more aggressive tax positions, could provoke backlash from tax directors and the general taxpaying public, and could encourage corporations' managers to resort to the courts to challenge the Service's characterizations of particular transactions as tax shelters rather than accept public brandings from the Service as tax shelter participants.

A. *The Chump Effect*

A perverse effect of publicly shaming corporations that participate in abusive tax shelters is that some corporate tax directors could respond to these sanctions by *increasing* their use of aggressive tax planning techniques. As a result of publicity that well-known, respected corporations have authorized the use of abusive tax shelters, conservative tax directors could develop the impression that their historic tax reporting practices have been *too* cautious. In response, these tax directors may alter their compliance with the tax law by increasing their use of aggressive corporate tax strategies. This reaction would be consistent with reciprocity theory, which attempts to explain why actors cooperate in collective action settings.¹⁷⁶ Below, I briefly discuss reciprocity theory as it relates to tax compliance and then hypothesize possible responses of certain tax directors to publicity that well-known, respected corporations have authorized the use of abusive tax shelters.

¹⁷⁶ For discussion of reciprocity theory, see Samuel Bowles & Herbert Gintis, *Is Equality Passé? Homo Reciprocans and the Future of Egalitarian Politics* (1998), available at <http://www.umass.edu/preferen/gintis/isinequa.pdf>; Ernst Fehr & Simon Gächter, *Reciprocity and Economics: The Economic Implications of Homo Reciprocans*, 42 *Eur. Econ. Rev.* 845 (1998); Dan M. Kahan, *The Logic of Reciprocity: Trust, Collective Action and Law*, 102 *Mich. L. Rev.* 71 (2003).

1. *Reciprocity Theory and Tax Compliance*

Reciprocity theory posits that an actor will contribute toward a public good only if he perceives that others are reciprocating his good behavior.¹⁷⁷ If the actor develops a perception that others are not contributing, but are, instead, free-riding, he may reduce his own contributions.¹⁷⁸ Reciprocity theory is relevant to any examination of tax compliance. Because some taxpayers may ignore their tax compliance obligations, yet enjoy the government benefits that compliant taxpayers fund, compliance with the tax system represents the model collective action problem.

Some adherents of reciprocity theory have argued that the use of shaming sanctions to punish tax evaders may cause taxpayers that correctly and timely pay their tax liabilities to reduce their own tax compliance. Dan Kahan, for example, has theorized that if the government were to reveal publicly that many taxpayers had failed to comply with their obligation to file tax returns or pay the proper amounts of tax, it could cause compliant taxpayers to assume that “more taxpayers than they thought are choosing to cheat.”¹⁷⁹ As Kahan notes, individuals may comply with the tax law when they perceive that others are paying their taxes,¹⁸⁰ but may reduce their own compliance if they perceive that tax cheating is rampant.¹⁸¹ No one wants to feel like a “chump” for paying taxes while others cheat.¹⁸²

Other scholars, however, have criticized this analysis, contending that shaming as a means of tax enforcement could alleviate, rather than exacerbate, the chump effect. In contrast to Kahan’s characterization, Stephen Mazza has defended the use of shaming sanctions to punish taxpayers that fail to comply with the tax system because it may enable the government to bolster public confidence in the taxing authority’s ability to detect, punish, and deter abuse.¹⁸³ According to Mazza, by implementing shaming sanctions in the tax compliance context, the taxing authority may “reassure those who are otherwise com-

¹⁷⁷ See Kahan, note 176, at 74.

¹⁷⁸ See Bowles & Gintis, note 176, at 10.

¹⁷⁹ Kahan, note 176, at 83.

¹⁸⁰ See *id.* at 82 (“If individuals believe those around them are inclined to pay their taxes, they will (as a result of guilt, shame, pride, and the like) be more likely to comply. . .”). See also Stephen Coleman, *The Minnesota Income Tax Compliance Experiment: State Tax Results*, Minnesota Dep’t of Revenue (Apr. 1996), available at <http://www.taxes.state.mn.us/> (reporting that news of high tax compliance had “positive effect on reported income and taxes paid” by individual taxpayers).

¹⁸¹ See, e.g., Steven M. Sheffrin & Robert K. Triest, *Can Brute Deterrence Backfire?, in Why People Pay Taxes 211-14* (Joel Slemrod ed., 1992) (demonstrating that taxpayers who read reports regarding the “tax gap” were less likely to comply with the tax system).

¹⁸² See, e.g., Janet Novack, *Are You a Chump?*, *Forbes*, Mar. 5, 2001, at 122 (discussing instances of general tax noncompliance).

¹⁸³ See Mazza, note 59, at 1081.

mitted to compliance that tax evaders are getting their just desserts.”¹⁸⁴ Further, Mazza argues that compliant taxpayers would be unlikely to reduce their own tax compliance in response to shaming sanctions because they may view the featured offenders as “dishonest outliers”¹⁸⁵ rather than individuals who share their moral values.

2. *Effect on Conservative Tax Directors*

If the government were to use shaming sanctions to punish the type of high-profile corporations that often engage in abusive tax planning, reciprocity theory suggests that conservative corporate tax directors could be encouraged to change their behavior by claiming tax positions that are more aggressive than those they historically have authorized.

When deciding whether to authorize the use of a particular corporate tax strategy, every tax director must reach his or her own determination of the likelihood that the Service would challenge or a court would reject the strategy as abusive.¹⁸⁶ This determination regarding the chances of an audit or judicial rejection of claimed tax benefits, as Sarah Lawsky has explained, represents the tax director’s “belief about whether the event will occur.”¹⁸⁷ This belief may be informed by advice from her corporation’s outside tax lawyers or accountants.¹⁸⁸

¹⁸⁴ Id. Leandra Lederman has also questioned Kahan’s reasoning regarding the effect of publicity of tax noncompliance on other taxpayers. Lederman, note 13, at 1484-88.

¹⁸⁵ Mazza, note 59, at 1080.

¹⁸⁶ Because the designation of a corporate tax strategy as abusive depends on the Service’s or a court’s ex post application of broad tax standards like the economic substance and business purpose doctrines, corporate tax directors frequently make tax reporting decisions under significant legal uncertainty. The Code presents a broad tax standard that defines a corporate tax shelter as a transaction with a “significant purpose of . . . avoidance of Federal income tax.” IRC § 6662(d)(2)(C). This guidance for corporations stands in marked contrast to the tax rules that the Code provides for individuals regarding whether their tax positions constitute tax shelters. In response to the individual tax shelter boom of the 1970’s and 1980’s, Congress enacted the passive loss provisions of § 469, which have been described as the “silver bullet” that halted the widespread use of abusive tax shelters by individuals. Chirelstein & Zelenak, note 2, at 1951. These provisions are clear, objective tax rules that dictate, in advance, that an individual may not use a particular scheme to claim valuable tax losses unless the individual “materially participates” in the activity. IRC § 469(h) (defining “material participation”). The Code, however, contains no parallel silver bullet rules that provide corporations with definitive advance notice that their claimed tax benefits are improper.

¹⁸⁷ Sarah B. Lawsky, *Probably? Understanding Tax Law’s Uncertainty*, 159 U. Pa. L. Rev. 1017, 1023 (2009).

¹⁸⁸ See id. at 1038.

The tolerance for pursuing tax strategies with uncertain legal outcomes varies among tax directors.¹⁸⁹ A conservative tax director may engage in a corporate tax strategy, for example, only if he believes there is at least a 70% chance that a court would respect the claimed tax benefits and a law firm has provided a legal opinion stating that the tax strategy “should” comply with the tax law.¹⁹⁰ An aggressive tax director, on the other hand, may implement a tax avoidance strategy even if he believes that the chances of success in court are low. The aggressive tax director may be comfortable authorizing the use of a tax strategy that he believes would have a 20% chance of success in court and regarding which a law firm has merely opined has a “reasonable basis” under the tax law.¹⁹¹

Tax directors currently operate under a certain level of ignorance regarding the tax positions that their counterparts at competing corporations have claimed. For example, a tax shelter promoter may call the tax director of every Fortune 500 corporation to pitch a new corporate tax reduction strategy that the promoter claims can enable a corporation to enjoy millions of dollars in foreign tax credits.¹⁹² When a conservative tax director receives this call, she may conclude that this tax strategy has a 20% chance of success. This probability of success is far below her belief threshold for tax strategy investment, so the tax director rejects the strategy as overly risky. While the tax director is aware that the tax shelter promoter is likely contacting many tax directors regarding the strategy, she is unaware of exactly how many or which of her counterparts at other corporations ultimately will decide to engage in the strategy.¹⁹³ She may even assume that

¹⁸⁹ For further discussion of the role of taxpayer identity as an aggressive or conservative type, see Blank, note 38, at 1656; Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 Colum. L. Rev. 689, 701 (2009), (describing taxpayers as “gamers” and “non-gamers”).

¹⁹⁰ For discussion of the range of legal opinions and their corresponding percentage chances of success, see Jasper L. Cummings, Jr., *The Range of Legal Tax Opinions, with Emphasis on the “Should” Opinion*, 98 Tax Notes 1125 (Feb. 17, 2003).

¹⁹¹ See *id.* at 1127.

¹⁹² See Bankman, note 1, at 1776, 1789 (discussing role of tax shelter promoter in mass-marketed tax shelters).

¹⁹³ There are several explanations for the current lack of transparency regarding the tax activities of corporations, including those that are publicly traded. First, as previously noted, the Service is prohibited from publicly revealing the contents of corporate tax returns. IRC § 6103(a). Second, despite efforts of the Financial Accounting Standards Board to force corporations to highlight in publicly available filings information regarding tax positions that they view as uncertain, see Financial Accounting Standards Board, *Accounting for Uncertainty in Income Taxes*, FASB Interpretation No. 48 (2006), available at <http://www.fasb.org/pdf/fin%2048.pdf>, corporations frequently provide vague explanations of such tax positions. For example, when describing its uncertain tax positions in accordance with FIN 48, one corporation stated that “[i]t is difficult to project how unrecognized tax benefits will change over the next 12 months but it is reasonably possible that they

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very few, if any, of her peer tax directors at other corporations would authorize their corporations to pursue the strategy since she quickly concluded that it had such a low probability of success.

The proposed shaming sanctions for corporate tax abuse, however, would alter the state of ignorance in which the typical conservative tax director currently makes decisions regarding potential tax avoidance strategies. In contrast to the curtain of taxpayer confidentiality that prevents tax directors from learning the tax positions that their counterparts at other corporations have claimed, shaming sanctions would publicly reveal the identity of some of the corporations that have pursued tax strategies that the conservative tax director believed to be abusive.

But how would shaming sanctions lead conservative tax directors to alter their tax reporting behavior? Would conservative tax directors begin authorizing the use of the very abusive tax strategies that shaming sanctions would reveal their aggressive counterparts at other corporations have authorized?

Such a copycat response from conservative tax directors is unrealistic. Shaming sanctions would at least define the specific tax strategies that the Service views as potentially abusive. Even some aggressive tax directors probably would cease participating in a tax strategy that has triggered a shaming sanction and instead explore other tax strategies of which the Service was not yet aware.¹⁹⁴ More importantly, reciprocity theory does not imply that upon learning of bad acts performed by others, compliant actors will imitate those precise bad acts. Rather, the theory posits that if compliant actors perceive that many other actors are not contributing toward a public good, they may reduce or change their own voluntary contributions.¹⁹⁵

Accordingly, the more likely manifestation of the chump effect in the context of corporate tax planning is that shaming sanctions could cause otherwise conservative tax directors to feel pressure, whether internally or at the direction of senior management, to increase aggressive tax planning. For example, if a conservative tax director were to learn, due to shaming sanctions, that a tax director of a well-known, respected corporation had authorized the use of a tax strategy that the conservative tax director believed had only a 20% chance of success

should change significantly.” Marie Leone, FIN 48: Standing Naked Before the IRS, May 22, 2007, available at <http://www.cfo.com/article.cfm/9216349>. Last, some tax shelters may be “homegrown,” the product of a single corporate tax director working with advisors, so that knowledge of this type of tax shelter may not be prevalent among tax directors.

¹⁹⁴ Similar responses from taxpayers have occurred in response to IRS designations of tax strategies as “listed transactions” or “transactions of interest.” See note 38 and accompanying text.

¹⁹⁵ See Bowles & Gintis, note 176, at 10.

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on the merits, the conservative tax director could begin to feel like a chump for only engaging in transactions that she believed had a 70% chance of success. Rather than insist that that her corporation only engage in tax strategies that she believed have a 70% chance of success on the merits, the information resulting from shaming sanctions could lead the conservative tax director to conclude that her corporation should pursue tax strategies that have a 51% chance of success (suitable for a “more likely than not” legal opinion from a tax lawyer¹⁹⁶) or even a 35% to 40% chance of success (suitable for a “substantial authority” legal opinion from a tax lawyer¹⁹⁷). Put differently, in response to publicity that the tax director of a well-known corporation had authorized the use of a highly questionable tax strategy, the conservative tax director could think to herself “if *that’s* the type of transaction that the Service views as a tax shelter, then we should consider adopting less conservative tax reporting behavior.”

There are significant reasons, in light of reciprocity theory, to suspect that the use of shaming sanctions to punish corporations that have pursued abusive tax shelters could cause conservative tax directors to feel like chumps for engaging in cautious tax reporting while other tax directors claimed tax positions at the opposite end of the spectrum.

First, the use of shaming sanctions for corporate tax abuse could reveal to conservative tax directors that the tax directors of highly visible, respected corporations—not rogues—have engaged in abusive tax activity. As Kahan has argued, if a taxpayer develops the impression that other taxpayers who share similar characteristics have failed to comply with the tax law, the taxpayer may develop a “reciprocal motive to evade.”¹⁹⁸ It is unlikely that a conservative tax director would describe the corporations that have participated in abusive tax shelters since the late 1990’s as rogues or “dishonest outliers.”¹⁹⁹ A sampling includes: American Home Products Corp.,²⁰⁰ Black & Decker,²⁰¹

¹⁹⁶ Reg. § 1.6662-4(g)(4).

¹⁹⁷ Reg. § 1.6662-4(d)(3); Sheldon I. Banoff, Dealing with the “Authorities”: Determining Valid Legal Authority in Advising Clients, Rendering Opinions, Preparing Tax Returns and Avoiding Penalties, 66 Taxes 1072, 1127-28 (1988).

¹⁹⁸ Kahan, note 176, at 83.

¹⁹⁹ Mazza, note 59, at 1080. The arguments of shaming advocates, like Mazza, are more persuasive when applied to settings where the government publicly shames taxpayers, such as tax delinquents, who have committed violations of explicit tax rules. State revenue officials have described these types of taxpayers publicly as “the worst of the worst” because they have simply refused to pay their outstanding tax liabilities despite repeated requests from the taxing authorities and even court orders. See Walters, note 138.

²⁰⁰ Randall Smith, IRS Battles Colgate Over an Arcane Deal That Cut Its Tax Bill, Wall St. J., May 3, 1996, at A1 (reporting testimony before Tax Court by Merrill executive regarding sale of tax shelter products to American Home Products Corp.).

²⁰¹ Black & Decker Corp. v. United States, 436 F.3d 431 (4th Cir. 2006).

Borden,²⁰² Colgate-Palmolive,²⁰³ Coltec Industries,²⁰⁴ Compaq,²⁰⁵ Dow Chemical,²⁰⁶ General Electric,²⁰⁷ GlaxoSmithKline,²⁰⁸ H.J. Heinz,²⁰⁹ Merck,²¹⁰ Merrill Lynch,²¹¹ Procter & Gamble,²¹² UPS,²¹³ Winn-Dixie²¹⁴ and Wal-Mart.²¹⁵ One reason why shaming sanctions could apply to such a list of corporations is that, unlike an act prohibited by a clear tax rule, corporate tax abuse is not an offense that corporate managers can identify with absolute certainty in advance. Many aggressive corporate tax managers, even at prominent corporations, have pursued tax strategies that, upon subsequent audit or review, the Service or a court has rejected as abusive.²¹⁶

Second, shaming sanctions may not produce visible reductions in corporate tax abuse, thus failing to convince conservative tax directors that the government has the ability to prevent its occurrence in the future. By attempting to shame corporations for engaging in an offense that is not absolutely apparent until an adjudicator applies a tax

²⁰² Smith, note 200, at A1 (reporting testimony before Tax Court by Merrill executive regarding sale of tax shelter products to Borden).

²⁰³ ACM Partnership v. Commissioner, 157 F.3d 231 (3d Cir. 1998).

²⁰⁴ Coltec Industries, Inc. v. United States, 454 F.3d 1340 (Fed. Cir. 2006).

²⁰⁵ Compaq v. Commissioner, 277 F.3d 778 (5th Cir. 2001).

²⁰⁶ Dow Chemical Co. v. United States, 435 F.3d 594 (6th Cir. 2006).

²⁰⁷ TIFD III-E Inc. v. United States, 459 F.3d 220 (2d Cir. 2006).

²⁰⁸ Press Release, IRS, IRS Accepts Settlement Offer in Largest Transfer Pricing Dispute (Sept. 11, 2006), available at <http://www.irs.gov/newsroom/article/0,,id=162359,00.html>.

²⁰⁹ H.J. Heinz Co. v. United States, 76 Fed. Cl. 570 (Fed. Cl. 2007).

²¹⁰ Press Release, note 85.

²¹¹ ACM Partnership v. Commissioner, 157 F.3d 231, 233 (3d Cir. 1998).

²¹² See Novack & Saunders, note 1, at 198 (discussing Procter and Gamble's participation in a "corporate-owned life insurance" tax shelter).

²¹³ United Parcel Service of America, Inc. v. Commissioner, 254 F.3d 1014 (11th Cir. 2001).

²¹⁴ Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (11th Cir. 2001).

²¹⁵ See Wal-Mart Stores, Inc. v. AIG Life Ins. Co., 860 A.2d. 312 (Del. 2004) (describing Wal-Mart's 2002 settlement with IRS regarding "corporate-owned life insurance" tax shelter).

²¹⁶ Consider, for example, the "Son of BOSS" tax strategy, one of the most infamous tax shelters of the last decade. Notice 2000-44, 2000-2 C.B. 255. When corporations initially pursued that strategy, which involved a partnership's assumption of liabilities in order to create an artificial tax loss, they did not know with certainty that the Service would later reject it as a tax shelter. The transaction appeared to fit within the literal confines of the relevant tax law. After the Service ruled that it considered the Son of BOSS strategy an abusive tax shelter, and designated it as a listed transaction, Notice 2000-44, 2000-2 C.B. 255, it announced that corporations that had participated in the strategy could enter settlements with the Service that offered certain favorable terms. See Press Release, IRS, Strong Response to "Son of BOSS" Settlement Initiative (July 1, 2004), available at <http://www.irs.gov/newsroom/article/0,,id=124937,00.html>. Within months, more than 1,500 taxpayers voluntarily approached the IRS to settle deficiencies related to this strategy. *Id.* If the Service were to adopt the shaming sanctions discussed earlier, it would publicize the names of the many corporations that had invested in this tax shelter.

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standard, the government could appear to conservative tax directors to be setting a mouse trap over and over again, without actually eradicating the mouse problem. In the fall of 2006, for example, former U.S. Assistant Treasury Secretary for Tax Policy, Pamela Olson, boldly declared: “the tax shelter war is over” and “[t]he government won.”²¹⁷ Following Olson’s public proclamation of victory, however, numerous high-profile tax shelter settlements and cases occurred.²¹⁸ If shaming sanctions were to fail to reduce dramatically instances of corporate tax abuse, conservative tax directors could develop the impression that abusive tax planning is widespread.²¹⁹

B. Backlash

Another unintended consequence of implementing public shaming as punishment for corporate tax abuse is that it could provoke harmful backlash from tax directors and from the general taxpaying public.

Some tax directors could react to the threat of shaming sanctions, at least in the short term, by complying with tax reporting obligations in ways that could reduce the chance that their corporations would be subject to the sanctions. A potential response from some tax directors to the threat of shaming sanctions could be to attempt to navigate the vast tax shelter reporting rules under current law by “overdisclosing” information that would fail to advance the agency’s tax shelter detection efforts.²²⁰

In addition, the use of shaming sanctions for this particular offense could weaken general taxpaying morale. Rather than protest or boycott the corporations that shaming sanctions would reveal have pursued abusive tax shelters, the general taxpaying public could turn its ire against the government that enacted loopholes in the corporate tax law that enabled these types of tax shelters to flourish.

²¹⁷ Pamela Olson, *Now that You’ve Caught the Bus, What Are You Going to Do with It? Observations from the Frontlines, the Sidelines, and Between the Lines, So to Speak*, Erwin Griswold Lecture, American College of Tax Counsel, reprinted in 60 *Tax Law* 567, 567 (2006).

²¹⁸ For example, since Olson’s announcement, the Service has: (1) litigated high-profile corporate tax shelter cases, see, e.g., *H.J. Heinz Co. v. United States*, 76 Fed. Cl. 570 (Fed. Cl. 2007), (2) issued public press releases announcing settlements with large corporate taxpayers, see, e.g., Press Release, note 208; and (3) designated new tax strategies as listed transactions, see Service Notice 2007-57, I.R.B. 2007-29 (describing loss importation transaction).

²¹⁹ By contrast, state revenue agencies have been attracted to shaming websites for tax delinquents because they apparently lead to significant and visible reductions in state tax delinquency that may reassure compliant taxpayers. See Walters, note 138. Consistent with this statement, Lederman concludes that taxpayers may not feel like chumps if they perceive that the government is cracking down on tax cheats. Lederman, note 13, at 1497.

²²⁰ See Blank, note 38, for detailed discussion.

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Below, I discuss each of these potential forms of backlash and why each form would be counterproductive to effective tax administration objectives.

1. *Overdisclosure as a Defense*

A perception appears to exist currently among some tax directors that tax shelter publicity may result in reputational harm for their corporations or for themselves.²²¹ As I have argued, the foundation of this fear is shaky.²²² If the government were to implement the types of shaming measures that their advocates have proposed, over time, tax directors would likely recognize that publicity of their corporations' abusive tax planning activities do not cause their feared harms—such as stock price drops, consumer outrage, and loss of their own jobs—to materialize.

But in the short term, some tax directors could respond to the threat of tax shelter publicity by attempting to protect their corporations from the application of shaming sanctions. A plausible avenue for avoiding shaming sanctions that tax directors could pursue could be to alter their compliance with the Service's tax shelter reporting rules.

The Service currently requires corporations to disclose significant information to it regarding certain activities that could bear tax shelter traits.²²³ Corporations must disclose detailed information regarding its participation in any listed transactions²²⁴ and other transactions that involve common features of tax shelters, such as transactions that are subject to confidentiality restrictions.²²⁵ At the extreme end of the spectrum, corporations must also disclose their participation in "transactions of interest,"²²⁶ which the Service has defined broadly as trans-

²²¹ According to a 2004 survey of 250 corporate tax directors conducted by Ernst & Young, 70% of the tax directors interviewed stated that "tax risk management is critical to preserving the organization's overall reputation" and nearly 75% stated that the opinions of media analysts are "an important factor in planning a new tax strategy." Ernst & Young, note 96, at 6; see also Canellos, note 98 ("corporations regard tax risk as an important aspect of overall risk management, subject to close CEO scrutiny because of its effect on reputation and 'franchise'"); PricewaterhouseCoopers LLP, note 104, at 9 (commenting that "more than one tax strategy we have seen have included policies such as 'We will not undertake any tax planning transaction which would reflect adversely on the group if details of it were to be published in the business pages of [Daily Newspaper Title]"); Martin A. Sullivan, Reputation or Lower Taxes?, 108 Tax Notes 981, 981 (Aug. 29, 2005)(describing management sensitivity to negative tax shelter publicity).

²²² See Part III.

²²³ Reg. § 1.6011-4 (taxpayer disclosure requirements).

²²⁴ Reg. § 1.6011-4(b)(2) (requirements for listed transactions).

²²⁵ Reg. § 1.6011-4(b)(1) (requirements for reportable transactions).

²²⁶ Reg. § 1.6011-4(b)(6) (requirements for transactions of interest).

actions that bear the “*potential* for tax avoidance or evasion. . .”²²⁷ The tax shelter disclosure rules are designed to provide the Service with information that will enable it to determine whether a particular corporation has engaged in a transaction that constitutes a tax shelter. As practitioners have commented, the broad scope of these rules, each of which “has a complicated definition, and exceptions to that definition, and then exceptions to the exceptions”²²⁸ has created a “tax environment of excessive reporting.”²²⁹

It is unlikely that tax directors would simply stop complying with the Service’s disclosure rules to protest its use of shaming sanctions. Although such an action could effectively deprive the Service of information critical to its ability to detect corporations’ participation in tax shelters and thus reduce the chance of shaming sanctions, the Service could subject their corporations to hefty monetary tax penalties for each act of nondisclosure.²³⁰ And under current law, a corporation that pays a monetary tax penalty for failing to disclose requested information to the Service must publicly disclose its payment of that tax penalty, which, after all, is a form of public shaming.²³¹ Nondisclosure, as a result, is an unattractive option.

A more likely response of tax directors to the threat of shaming sanctions for corporate tax abuse could be to *overdisclose* information regarding their corporations’ tax activities to the Service. Rather than simply provide the Service with concise and specific information about a corporation’s most questionable tax positions, a tax director could provide the Service with voluminous information about every transaction that arguably fits within one of the tax shelter reporting categories.²³² Since Congress enacted in 2004 high monetary penalties for corporations that fail to disclose participation in reportable transactions, tax directors have frequently engaged in overdisclosure to avoid the monetary penalties without raising clearly visible red flags for auditors regarding suspect transactions.²³³

Overdisclosure would be a natural strategy for a tax director who could be concerned that the Service could subject her corporation to

²²⁷ Notice of Proposed Rulemaking, 71 F.R. 64488 (Nov. 2, 2006) (emphasis added).

²²⁸ Mark Weinstein & Sarah Lawsky, *Tax Shelter Angst*, GC New York, Feb. 13, 2006 at 1, available at http://www.hhlaw.com/files/Publication/80df4ec1-63a9-420d-b8dc-14a78f041399/Presentation/PublicationAttachment/9736f34b-034a-4ea7-a376-6df7d1105c03/Weinstein_Lawsky_article.pdf.

²²⁹ *Id.* at 1.

²³⁰ See note 64.

²³¹ See note 65.

²³² For detailed discussion of overdisclosure in response to the enactment of high monetary penalties for taxpayers that fail to disclose to the Service information required by the tax shelter reporting rules, see Blank, note 38, at 1662-64.

²³³ See *id.*

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shaming sanctions as a result of any of her corporation's aggressive tax positions. The overdisclosure strategy could force the Service to focus on documentation regarding highly complex transactions that ultimately may lack abusive tax shelter qualities, rather than tax strategies that are motivated primarily by tax-avoidance purposes. Using this strategy, a tax director could comply in a technical sense with the tax shelter reporting rules, while diminishing the Service's opportunity to detect the corporation's use of the type of abusive tax strategies would likely result in the imposition of shaming sanctions.

Tax directors would have many incentives under current law to pursue the strategy of overdisclosure in response to the risk of shaming sanctions. Unlike acts of nondisclosure, corporations are subject to no monetary tax penalty for providing the Service with multiple reportable transaction statements or excessive quantities of information. Indeed, the Regulations appear to encourage the overdisclosure reaction. Corporations are required to disclose information to the Service regarding transactions that are "substantially similar"²³⁴ to listed transactions and transactions of interest. The Regulations comment that this phrase should be "broadly construed in favor of disclosure."²³⁵ Overdisclosure could be an effective, yet permissible, way for tax directors to impede the ability of the Service to publicize their corporations' use of tax shelters.

The risk of overdisclosure could diminish the Service's ability to combat the corporate tax abuse problem. When corporations provide the Service with detailed information about their most questionable transactions or those that contain obvious tax shelter traits, the Service may identify certain trends in aggressive tax planning and issue targeted administrative notices that could prevent corporations from engaging in these strategies in the future.²³⁶ If corporations deliver so much information to the Service that its agents must spend excessive time reviewing it, however, the value of the information disclosed decreases. As a representative of the Service's Large and Midsize Division commented in 2006, "If the default approach becomes disclosing every transaction, the system is not going to work."²³⁷

²³⁴ Reg. § 1.6011-4(b)(2).

²³⁵ Reg. § 1.6011-4(c)(4).

²³⁶ Former Commissioner of Internal Revenue Charles Rossotti has stated that disclosure of a wide array of information enables the Service to "distinguish between a legitimate business transaction and one that inappropriately manipulates the Code." Press Release, U.S. Treas. Dep't, Statement of Commissioner of Internal Revenue Charles O. Rossotti on Corporate Tax Shelters (Mar. 20, 2002), available at <http://ustreas.gov/press/releases/po2020.htm>.

²³⁷ Crystal Tandon, IRS Seeing Overdisclosure of Reportable Transactions, Officials Say, 2006 TNT 197-2 (Oct. 12, 2006), available in LEXIS, Tax Analysts File (quoting Christopher B. Sterner, IRS Division Counsel, Large and Midsize Business Division).

2. *Decrease in Taxpaying Morale*

Publicity that high-profile corporations have engaged in abusive tax activity could also weaken general taxpaying morale, the willingness of taxpayers to trust and support the Service.²³⁸ Upon learning of specific instances of high-profile corporate tax abuse, taxpayers could assume that the problem of tax avoidance is so widespread that the Service is incapable of controlling it. They could make this intuitive leap because individuals often make judgments as a result of what they can easily remember, such as the actions of a few highly visible corporations, rather than a complete data set.²³⁹ Individual taxpayers have commented, for example, that the corporate tax abuse problem is so widespread that the Service “is a poor match against Goliath corporations.”²⁴⁰

Further, rather than expressing outrage at the corporations that would subject be to shaming sanctions, taxpayers could instead turn their anger toward Congress and the Service for allowing corporate tax “loopholes” to exist.²⁴¹

A decrease in general taxpaying morale as a result of publicity of corporate tax abuse could have adverse consequences for tax administration efforts. Studies have demonstrated that weakened taxpaying morale tends to lead to reductions in overall tax compliance.²⁴² Further, public outrage over the government’s inability to prevent the exploitation of statutory loopholes in the past could inhibit the Service’s frequent attempts to garner public support for increased enforcement resources.²⁴³ The general public could perceive shaming sanctions as

²³⁸ See Bruno S. Frey & Benno Torgler, *Tax Morale and Conditional Cooperation*, 35 *J. Comp. Econ.* 136, 136 (2007) (finding “a high correlation between perceived tax evasion and tax morale”).

²³⁹ See Daniel Kahneman & Amos Tversky, *Availability: A Heuristic for Judging Frequency and Probability*, 5 *Cog. Psych.* 207 (1974) (describing the “availability” heuristic).

²⁴⁰ Pragna Patel, *Letter to the Editor, Avoiding Taxes: Shelters of Shame*, *N.Y. Times*, Dec. 20, 2000, at 17A.

²⁴¹ Consider, for example, one citizen’s letter to the editor following a newspaper article detailing instances of corporate tax abuse: “I can’t believe that the ‘representatives’ we pay can be so incompetent as to make regulations that allow companies to avoid taxes (that I have to make up) . . . How is it that the crooks are always smarter than the people we pay to represent us, and why does it take so long to start action to close the loopholes that shouldn’t have existed in the first place?” W.L. Head, *Letter to the Editor, Close the Loopholes Before They Open*, *St. Pete. Times*, Mar. 15, 2000, at 17A. Put differently, in the immortal words of Edward Albee, “You gotta have swine to show you where the truffles are.” Edward Albee, *Who’s Afraid of Virginia Woolf?* (1962).

²⁴² See Sheffrin & Triest, note 181, at 211-14.

²⁴³ Some scholars have speculated that the Service deliberately fuels reports that its budget is limited to create pressure on Congress to increase its resources. See, e.g., Kahan, note 176, at 84.

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an indication that the Service has merely collected “low-hanging fruit,” rather than eliminated corporations’ aggressive tax planning.²⁴⁴

C. Increased Litigation

Last, the use of shaming sanctions could inadvertently encourage tax shelter litigation, which, in turn, could further deteriorate public confidence in the tax system.

1. Public Versus Private Dispute Resolution

A regime of shaming sanctions could reduce the negotiating leverage that the Service currently possesses when attempting to resolve tax shelter disputes with corporations. Today, a corporation’s tax director generally has two choices upon receiving notice from the Service that it believes his corporation has participated in a tax shelter: He can settle the dispute with the Service or challenge the Service’s characterization in U.S. Tax Court, District Court, or the U.S. Court of Federal Claims.²⁴⁵ If the tax director settles with the Service, the corporation’s concession that it has engaged in a tax shelter occurs behind a curtain of taxpayer confidentiality;²⁴⁶ if the tax director chooses to litigate, however, the corporation’s challenge occurs in the sunlight of the public courts. The Service has used this distinction to its advantage in the past tax shelter disputes by convincing “publicity-averse” corporate tax directors to settle close cases rather than litigate.²⁴⁷ Although the fear that tax shelter publicity could harm a corporation’s reputation may be unfounded, some tax directors possess this fear and attribute value to the confidential nature of settlement as a way to resolve tax shelter disputes.

It is possible, therefore, that shaming sanctions would cause some corporations to choose litigation over settlement. Of course, litigation, like settlement accompanied by a shaming sanction, would force a corporation to reveal its involvement in a transaction deemed by the Service to be a tax shelter. But litigation, unlike settlement, would provide a corporation with the opportunity to tell its side of the story

²⁴⁴ One veteran IRS agent has compared his audits of the largest corporations’ tax returns, each of which may consist of tens of thousands of pages, to working in an orchard without ladders, where “[y]ou can grab all the low-hanging fruit in a few highly productive hours, while leaving most of the harvest untouched.” David Cay Johnston, I.R.S. Agents Feel Pressed to End Cases, N.Y. Times, Mar. 20, 2007, at A1.

²⁴⁵ See IRC § 6213 (procedures for Tax Court litigation), § 7422 (procedures for civil actions for tax refunds).

²⁴⁶ See IRC § 6103(a).

²⁴⁷ Press Release, IRS, IRS Settlement Initiative (Oct. 2005) available at <http://www.irs.gov/irs/article/0,,id=150073,00.html> (describing terms of initiative to enter settlements with taxpayers regarding listed transactions, including taxpayer confidentiality).

publicly. A corporation's managers could make arguments in a trial that could persuade the community that they did not believe they were violating any rules when claiming the tax position at issue. As tax shelter litigation tends to attract attention in the business press and mainstream media, it could enable a corporation's managers to deflect potential reputational harm that tax shelter publicity could cause.

Further, a publicity-averse tax director could favor public litigation over public settlement because the nature of tax shelters means there is a significant chance that his corporation could prevail on substantive legal grounds. Because "economic substance" and "business purpose" essentially exist in the eye of the beholder,²⁴⁸ it is possible that a court could disagree with the Service's assertion that a particular transaction lacks these qualities.²⁴⁹ A judicial victory would certainly reduce a perception in the community's eyes that the corporation is a "tax cheat" or that its managers otherwise have "clouded business ethics."²⁵⁰ The possibility of judicial affirmation of a corporation's tax position could entice the publicity-averse tax director to litigate rather than accept the branding of his corporation as a tax shelter participant.

2. *Dangers of Increased Litigation*

Increased tax shelter litigation is problematic because it could amplify publicity of abusive tax activities of corporations, raise the possibility that the government could suffer high-profile judicial losses, and drain valuable enforcement resources that the government otherwise could use to address other, more costly types of tax noncompliance.

High-profile tax shelter trials could raise public consciousness of abusive tax activities of corporations, possibly exacerbating the chump effect among conservative tax directors.²⁵¹ Litigation, of course, extends over significant periods of time and could attract even more coverage in the business and other press than an announcement by the Service that a particular corporation has paid a monetary tax penalty for participating in a tax shelter. Further, litigation would force the government to describe, in detail and in public, why a particular corporation's tax position results from a sham transaction. If shaming sanctions could increase the frequency of tax shelter litigation, such

²⁴⁸ For further discussion, see Lederman, note 13, at 30-58.

²⁴⁹ See note 252 and accompanying text for discussion of the inconsistent judicial case law regarding corporate tax shelters.

²⁵⁰ See Grassley, note 77.

²⁵¹ For discussion of the chump effect, see notes 176-219 and accompanying text. [X]

increased publicity could reinforce the perception of compliant taxpayers that corporate tax abuse is widespread.

A more significant problem is that it is possible that courts in high-profile cases could disagree with the Service's application of standards like the economic substance requirement. The government has lost significant tax shelter cases for this reason over the last decade.²⁵² In *Black & Decker's* litigation with the Service over its contingent liability tax shelter, for example, the trial court in the case sided with the corporation.²⁵³ The judge openly admired *Black & Decker's* literal reading of the Code as "a thing of grace and beauty."²⁵⁴ Similar judicial losses could lead taxpayers to view corporate tax abuse not as a socially offensive act, but rather as an exercise in creative statutory interpretation. This perception could lead corporations to embrace aggressive tax planning. As one commentator noted, the district court decision in *Black & Decker* "seemed to encourage taxpayers to continue to regard hefty tax advantages as a key element in planning their business affairs."²⁵⁵

An increase in tax shelter litigation could also consume valuable tax enforcement resources. The increased expense seems especially excessive when considering that corporate tax abuse actually represents a relatively small portion of the overall federal tax gap. According to Treasury, in 2001, the tax gap was \$345 billion.²⁵⁶ Of this \$345 billion tax gap, less than 10% of it, \$32 billion, was attributable to corporate tax noncompliance.²⁵⁷ Individual income and employment tax noncompliance, on the other hand, represents the vast bulk of the tax gap. By encouraging more corporations to pursue tax shelter litigation, shaming sanctions could force the government to spend valuable tax enforcement resources on defending its tax findings in court, rather than on preventing more costly forms of tax noncompliance.

²⁵² See, e.g., *Compaq v. Commissioner*, 277 F.3d 778 (5th Cir. 2001); *Boca Investering P'ship v. United States*, 314 F.3d 625 (D.C. Cir. 2003) (involving transaction of American Home Products); *IES Industries, Inc. v. U.S.*, 253 F.3d 350 (8th Cir. 2001); *United Parcel Service of America, Inc. v. Commissioner*, 254 F.3d 1014 (11th Cir. 2001).

²⁵³ *Black & Decker Corp. v. United States*, 340 F. Supp.2d 621 (D. Md. 2004).

²⁵⁴ Transcript of Motions Hearing Before the Honorable William D. Quarles 28-29 (July 30, 2004), discussed in Karen C. Burke, *Black & Decker's Contingent Liability Shelter: "A Thing of Grace and Beauty"?*, 106 Tax Notes 577 (Jan. 31, 2005).

²⁵⁵ Leone, note 115.

²⁵⁶ Treasury Dep't, Office of Tax Pol'y, *A Comprehensive Strategy for Reducing the Tax Gap 6* (2006), available at <http://www.ustreas.gov/press/releases/reports/otptaxgapstrategy%20final.pdf>.

²⁵⁷ *Id.* at 6.

V. CONCLUSION

This Article has offered a comprehensive analysis of the use of shaming sanctions to address the problem of corporate tax abuse. As I have argued, there are strong reasons to doubt that the threat of corporate shaming sanctions could effectively deter corporate managers from pursuing abusive tax shelters. There are also strong reasons to suspect that, when applied to this particular type of tax offense, shaming sanctions could have potentially adverse effects on important aspects of tax compliance.

The use of shaming sanctions would be unlikely to achieve deterrence objectives. The community's lack of hostility in the past toward corporations that have pursued tax shelters, the potential for shaming sanctions to send a positive signal to investors searching for corporations with aggressive tax directors, and the low probability of personal loss for tax directors are factors that, taken together, could cause corporate managers to discount heavily the adverse consequences of shaming sanctions.

Further, the use of shaming sanctions could result in unintended consequences that could weaken aspects of tax compliance. If the government were to apply shaming sanctions against corporate tax shelter participants, otherwise conservative tax directors could alter their own tax reporting behavior in response; some tax directors could hamper the Service's detection efforts by overdisclosing information to the agency; general taxpaying morale could decline; and tax directors could resort to expensive litigation to challenge the Service's *ex post* characterizations of particular transactions as tax shelters.

Justice Louis Brandeis once famously commented of public disclosure efforts, "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."²⁵⁸ As this Article has demonstrated, however, in the context of corporate tax abuse, the power of the public spotlight may not only be dim, but may have a dark side as well.

²⁵⁸ Louis D. Brandeis, *Other People's Money and How The Bankers Use It* 92 (1914).