

# Taxation by Confession:

How the IRS persuades Americans to pay income taxes

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# I Introduction

“The United States has a system of taxation by confession. That a people so numerous, scattered and individualistic annually assesses itself with a tax liability, often in highly burdensome amounts, is a reassuring sign of the stability and vitality of our system of self-government. What surprised me in once trying to help administer these laws was not to discover examples of recalcitrance, fraud or self-serving mistakes in reporting, but to discover that such derelictions were so few.”

—Justice Robert H. Jackson, *United States v. Kahriger*, 1953

By most accounts, Americans are remarkably tax compliant. IRS data from 2012 reports that just over 83% of Americans pay their income taxes in full and on time.<sup>1</sup> This is surprising for two reasons. First, recent statistics released by the IRS show us that the probability of being caught cheating is very low—only 1.1% of all income tax returns were audited in fiscal year 2010; a figure that is more than halved if, like most Americans, your income is below \$200,000 per year.<sup>2</sup> Second, while comparing compliance across countries is complicated (governments vary in ability to accurately measure compliance, and in the methodology they use to do so), current research suggests that American compliance rates are significantly higher than compliance rates in comparably developed countries, many of which have compliance rates near seventy-five percent.<sup>3</sup>

These data beg the question of how the U.S. government—and the IRS in particular—has managed to maintain such high compliance rates. What strategies has the IRS used to encourage compliance, and how have these strategies changed over the years?

This paper will maintain that the IRS has utilized a variety of strategies over the past century and a half, but that these strategies have coalesced around a mostly punitive strategy in the past few decades. This shift in strategies can best be ex-

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<sup>1</sup>See Internal Revenue Service (2012) for the full news release.

<sup>2</sup>See the Internal Revenue Service’s datebook release (2010, p.22).

<sup>3</sup>See Christie and Holzner (2006) for a discussion of the difficulties in comparing cross-country compliance, and a list of compliance rates comparing European countries.

plained through the lens of the political and economic conditions during World War II: the reason the IRS switched from a norm-creating to a more punitive and intrusive institution is because during that war, the IRS had a powerful war machine with which to bundle its tax compliance message. However, since the end of that war, the United States has not encountered similar political or economic conditions amenable to the socializing effort used by the IRS during the 1940s.

This paper will proceed as follows. First, I will discuss a brief overview of the IRS's strategies, and provide evidence for the contention that these strategies have fundamentally shifted. Next, I will attempt to explain that shift, using the financial and political conditions of World War II to demonstrate that at least one strategy of the IRS—norm-creation—was heavily dependent on a particular moment in U.S. history. I will conclude by describing what this means for the future of IRS strategies—and perhaps even for U.S. compliance rates.

## II The Trajectory of the IRS

The Internal Revenue Service has used a variety of tactics to enforce tax compliance since its birth a century and half ago. While no doubt many Americans associate the IRS with punitive strategies (namely, the audit process), the IRS relied heavily on normative strategies in its early years.

Interesting examples of these strategies are evident in the attempts by the IRS (then called the Internal Revenue Bureau, or IRB) to encourage compliance during World War I. According to the IRS's own historical account, the IRB initiated a "special public education program" following the new Revenue Act of 1916 to help instruct citizens about their responsibilities as taxpayers (Internal Revenue Service, 1963, p.15). These public education efforts were often paired with attempts to connect paying income taxes with a sense of moral obligation in the minds of the American public, as seen most clearly by the IRB's active efforts to encourage members of the clergy to discuss taxation with their congregations: in the same historical account, the IRS proudly declares that "thousands of sermons around the country

that year had taxation as a theme.”

Without question, the most active period of norm-creation for the IRS was in the thick of World War II. The Revenue Act of 1942 had effectively transformed the income tax from a tax on the wealthy to a tax on working people: by lowering the personal exemption from \$750 to \$500, the Revenue Act of 1942 more than doubled the number of individuals who would owe income tax—and when we include the effects of the Victory Tax, the joint effects of these two measures *more than quadrupled* the number of taxpayers owing income tax. Perhaps unsurprisingly, then, government officials expressed concern over whether the income tax laws would be obeyed by newly targeted Americans, who had little experience with filling out income tax forms and, perhaps more importantly, little incentive to comply.

There was therefore a need to associate paying income taxes with the survival of the nation, or, even more dramatically, with the survival of civilization itself: as Commissioner of the Internal Revenue Mortimer M. Caplin wrote in a letter to taxpayers, “The citizenship obligation to pay correct taxes—to provide the resources for protecting our Nation in these most uncertain and dangerous times—is not a light burden. Yet, most of our people meet this obligation well, realizing that taxes are truly ‘the price we pay for civilization’” (Internal Revenue Service, 1963, p.iii). Not only were these messages permeated with appeals to nationalism, but the repeated stress on the compliance of the American taxpayer also incorporated appeals to social norms of conformity—you should pay your taxes because *most good Americans* pay their taxes.

According to Jones (1996), instilling the sense of taxpaying as a social norm was particularly popular with IRS administrators during this time period. Rather than relying exclusively on official channels to distribute messages about taxation, great effort was taken to distribute these messages through more unofficial media: a ‘grass roots’ effort was undertaken, with the express belief that local face-to-face tax education would be more palatable and more effective than government-issued education (Jones, 1996, 116-117). Thus, union leaders were instructed to ask their members whether they had filed their taxes yet; teachers were told to instruct their students about income tax forms; clergy were told to instruct their congregations

about taxes; and so on.

Indeed, the desire to cloak a governmental message in the more appealing guise of social pressure even inspired the IRS to slip its message into popular films, radio, newspapers, and magazines—most famously, with the commissioned Walt Disney short film, *The New Spirit*, featuring Donald Duck as a compliant taxpayer (and consequentially, as a patriotic American citizen proudly helping the war effort). Rather than focusing its efforts on scaring Americans with messages about the consequences of failing to comply, the IRB was heavily concerned with convincing the American public that paying taxes was morally and socially required, and perhaps just as importantly, that it was something *everybody* did—members of your community, famous Hollywood stars, and as one promotional campaign stressed, fifty million other Americans.<sup>4</sup>

After World War II, the IRB (soon to be renamed the IRS) made a noticeable shift away from these norm-creating messages. While government administrators laid a heavy emphasis on creating a culture of civic-minded American taxpayers, post-war messages consisted largely of “identifiable government officials speaking about tax issues” through the usual administrative channels (Jones, 1996, p.127). But the conduits through which information was sent was not the only major shift: the strategy of the IRS shifted away from taxpaying as a moral good or as a social norm, and toward an approach that focused “primarily on a deterrence model of enforcement” (Kinsey, 1992, p.260). \*See: Bardach and Kagan (1982).

\*Show examples here: statistics on number of audits, or percentage of budget spent on enforcement activities.

Certainly, efforts have been made to improve customer service and public perceptions of the fairness of the IRS (as noted by Smith 1992 and Lipset and Schneider 1983\*, and reinforced by IRS documents such as Internal Revenue Service 1990\*). But while this ‘softer’ IRS (exemplified by the creation of the Taxpayer Advocate Service in 1998) may be geared toward providing improved customer service, the agency still under-utilizes norm creation and over-utilizes punitive enforcement compared to

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<sup>4</sup>See a gallery of World War II tax propaganda at <http://www.taxhistory.org>.

the IRS of World War II.

What explains this trajectory?

### III Explaining the Shift

The critical juncture that explains the shift from normative to punitive strategies is the loss of the World War II propaganda machine. The war machine made the expansion of the income tax financially and politically possible, and provided resources to fund the normative approaches discussed earlier. Unsurprisingly, then, the shift in IRS strategy is a result of the loss of that war machine, which imposed both financial and political limits on the IRS's strategy options.

#### III.I Financial Conditions

The norm-creation approach was made economically feasible during the war years, primarily through the shared resources available to the IRS through joint efforts with the newly created Office of War Information (OWI).

According to Jones (1988, p.702), most of the important decisions about the content of income tax propaganda were made by the Treasury, not the OWI—but the OWI provided critical resources for spreading tax propaganda through radio and the press.

\*Discuss degree to which OWI financed tax propaganda (see *How to Raise \$16 Billion* in (Winkler, 1978, p.56), and *The New Spirit* in Jones (1988)).

#### III.II Political Conditions

Income tax propaganda was only politically palatable for a short window of time: the economic strain of World War II induced a remarkable (though by no means uninhibited) degree of bipartisan agreement in government, without which the income tax would never have expanded in 1942, and without which the IRS's propaganda campaign would not have been politically viable.

The political climate surrounding the Revenue Act of 1942 demonstrates the degree to which the need for wartime funds trumped other considerations. The bill that would enact the most sweeping changes to the American tax system since the civil war passed with surprising ease. According to the diaries of Treasury Secretary Morgenthau (collected by John M. Blum), the Revenue Act of 1942 was so large and complex, and the need for wartime funds so pressing, that Under Secretary of the Treasury Daniel Bell reported that President Roosevelt “didn’t understand [the bill] and didn’t think the Treasury understood it... He was told to sign it that day in order to save some \$60 million revenue, so that he was forced to sign it without reading it. He made quite a joke of the whole thing” (Blum, 1967, p.51).

Similar pressures were working within Congress to enable the bill to pass remarkably quickly. While we might expect such a bill to produce enormous disagreement in both houses of the legislature, the financial pressure of the war acted as a unifying force. As Witte (1986, p.130) explains:

Although there were always conflicts over the exact composition of revenue laws and later in the war this consensus broke down, the war dictated tax increases and forced a reluctant Congress to accept the important principle that almost no one should be immune from carrying some of the tax burden. As a consequence, the tax bills of 1940, 1941, and 1942 were enacted quickly and by overwhelming bipartisan majorities.

Indeed, after a mere “three days of debate laden with calls for sacrifice in the face of war,” the Revenue Act of 1942 was passed by a vote in the House with 295 for and 2 against, and was passed after five days of debate in the Senate, with votes declaring 77 for and 0 against (Witte, 1986, p.117). While there was certainly disagreement over the particulars of the bill (such as the equity of the bill and the pay-as-you-go provision),<sup>5</sup> partisan bickering was remarkably hushed during the birth of an important piece of legislation that would affect millions of American taxpayers.

Pressure to finance the war paved the way for various political efforts that no doubt would have been difficult during peacetime. According to Winkler (1978), the

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<sup>5</sup>See Witte (1986, p.117-120) for an in-depth discussion of these arguments.

U.S. government was in a very specific position during the war years that enabled the Roosevelt administration to create the World War II propaganda machine in the form of the OWI.

Three political pressures made the creation of the OWI possible. First, despite the American public's suspicion of propaganda (a result of the overblown and irresponsible propaganda campaigns under George Creel's Committee on Public Information (CPI) during World War I), the government, media, and American people desired a centralized information agency to help coordinate the erratic, incomplete, and confusing information made available by multiple agencies during the beginning of the war. In other words, there was demand for a coordinated agency tasked with the job of reporting to the public about the state of the war effort abroad.

Second, there was a need to combat the propaganda machines operating in Axis countries—thus, a home-grown administrative body tasked the production of propaganda was considered necessary for the war effort (Winkler, 1978, p.29). Whereas the first motivation implied a need for messaging and communication at the domestic level, this second motivation suggested that messaging oriented toward a foreign audience was also a necessity.

These first two motivations were perhaps the least controversial. The third motivation, on the other hand, created some disagreement outside and within the OWI, as the new agency struggled to understand its role and mandate during the war. Controversially, some administrators in OWI perceived need to motivate Americans to contribute (through scrap drives, rationing, buying war bonds, and other supportive activities) and to unite Americans behind the war effort. This last consideration was based on polls showing that as late as December 1942, 35% of the American public did not have a clear idea of what we were fighting for, while other polls showed that many Americans felt suspicious of U.S. allies (Winkler, 1978, p.54). In other words, there was a perceived need to direct propaganda inwards as well as outwards, in order to sustain the support of the American public and encourage supportive acts that could help sustain the war effort.

This propaganda machine was enormously important for the IRB's tax propaganda efforts. In the first place, appeals to pay income taxes could be placed on



the same footing as buying war bonds, and thus blend seamlessly into the propaganda efforts of the OWI. In the second place, the OWI actively funded income tax propaganda that could not have been funded with the IRB's limited budget.

### **III.III Without the War Machine**

When the war ended, the loss of the war machine imposed financial limits on the strategies available to IRS officials.

What brought down the OWI? First, none of these conditions continued following WWII: there was no need for an office of war information during peacetime. Second, there was considerable inter-agency bickering (and intergovernmental bickering) over the policies pursued by the OWI; leaders in the armed forces were opposed to the candid release of information about military weaknesses and defeats, and some Republican Congressmen were suspicious that the OWI was little more than a facade for Roosevelt's next re-election campaign (Winkler, 1978, p.66). There was also disagreement within and outside the OWI about whether the information produced by OWI should be truthful and impartial, or should act to persuade the American people about the importance of the war effort. The propaganda effort that was accepted during wartime was no longer thinkable in peacetime. It makes sense, then, that the OWI was a purely wartime phenomenon.

So why didn't the OWI resurrect itself in other wars? We have not had a war since WWII that the public was encouraged to involve itself in. Korea, Vietnam, Grenada, the Gulf War, Afghanistan, the Iraq War... these 'police actions,' 'invasions,' and so on, were not characterized as full-scale war efforts that required the backing of the American people. Rather, we live in a post-war America; the government doesn't want to remind us that "non-wars" really exist, and certainly doesn't want to show us how expensive they are, or suggest that Americans must sacrifice to win them. Because these wars are not waged with the intention of uniting the country, there likely isn't constituent or Congressional support for a propaganda machine.

## IV Conclusion

\*Discuss argument by Jones (1996) that the IRS shift was because Americans ‘didn’t need’ to be socialized anymore: Jones (1996): “Without the OWI to mobilize and coordinate radio programming for the war effort as a whole, for example, it may have been difficult for the Treasury alone to secure sufficient mass media interest. Second, it may also have been that such ‘selling of the income tax’ became less essential as average Americans became accustomed to their status as income taxpayers.” In this latter explanation, propaganda was no longer necessary because the norm of taxpaying had been successfully spawned. Therefore, “As the coercive narrowly targeted tax of the 1930’s was forgotten and a mass tax became the norm, one would also expect a return to harsh or punitive propaganda directed at those who failed to pay their ‘fair share.’” (p.737). But we didn’t see this—we saw a virtual end to propaganda efforts. Why?

If propaganda had been so successful in creating a norm of tax compliance (and it was, implicitly, cheaper than punitive strategies, as suggested on p.735), why would they stop? Why shift from the cheaper, more effective strategy to a more expensive, more abrasive, and less effective strategy?

Two answers: 1) they couldn’t once the war ended; 2) they haven’t been able to since *that* war ended (it was the last domestically-oriented propaganda war).

Discuss implications for IRS strategies and U.S. compliance rates

## V Appendix

### V.I Chronology of the American Income Tax

- 1861 ————— *Start of the American Civil War* —————
- 1862 Internal Revenue Bureau is created under President Lincoln, and the first income tax of 3% is levied on incomes from \$600-\$10,000, and 5% on incomes over \$10,000
- 1865 ————— *End of the American Civil War* —————
- 1872 Income tax is repealed due to public opposition
- 1894 The Wilson Tariff Act revives the income tax
- 1895 Supreme Court rules the income tax unconstitutional on the basis that it constitutes a direct tax that had not been apportioned equally according to population as required by the Constitution
- 1913 President Taft pushes through the 16<sup>th</sup> Amendment, granting Congress “the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration”
- 1913 Congress passes an income tax of 1% on net personal incomes over \$3,000 and a surtax of up to 6% on personal incomes over \$500,000
- 1913 Personal Income Tax Division established to educate the public about the personal income tax
- 1913 Collection at the source (a precursor to withholding) first enacted
- 1914 Birth of Form 1040
- 1916 Revenue Act of 1916 raises income tax rates: up to 2% on net incomes over \$3,000, with a surtax of up to 6% on incomes over \$500,000 and up to 13% on incomes over \$2 million; also required publication of income tax statistics by the IRB and repeals collection at the source provisions

- 1917 ————— *Start of U.S. involvement in World War I* —————
- 1917 War Revenue Act of 1917 raises income taxes by 2% on incomes over \$1,000, with graduated surtaxes up to 63%; also leads to the expansion and reorganization of the IRS
- 1917 IRB launches special public education program, including cooperation from the clergy
- 1918 Revenue Act of 1918 introduces a progressive income tax structure with a top tax rate of 77%, and the IRB launches the Intelligence Division to prevent tax fraud
- 1918 ————— *End of World War I* —————
- 1937 Social Security Tax Division set up in the IRS
- 1941 ————— *Start of U.S. involvement in World War II* —————
- 1941 Revenue Acts of 1940 and 1941 more than triple the number of Americans paying income taxes; short form return is adopted to ease income tax confusion
- 1942 Revenue Act of 1942 triples the income tax base (when including the effects of the Victory Tax) by lowering the personal exemption from \$750 to \$500, and increases tax rates to 13% for net incomes of \$2,000, up to a top rate of 82% on net incomes over \$200,000
- 1943 Ruml's Current Tax Payment Act (the modern withholding system) is enacted
- 1944 Standard deduction of 10% enacted as part of the Individual Income Tax Act of 1944, and the personal exemption was made uniform at \$500
- 1945 ————— *End of World War II* —————
- 1948 The joint return is enacted, and the individual exemption is raised to \$600
- 1950 ————— *Start of U.S. involvement in the Korean War* —————
- 1950 Social Security Act of 1950 extends coverage to the self-employed, raises taxes, and broadens the tax base
- 1951 Investigations into IRB employee misconduct leads to administrative overhaul in 1952

- 1953 ————— *End of U.S. involvement in the Korean War* —————
- 1953 Internal Revenue Bureau is renamed the Internal Revenue Service
- 1953 ————— *Start of U.S. involvement in the Vietnam War* —————
- 1965 IRS creates first toll-free telephone service
- 1975 ————— *End of U.S. involvement in the Vietnam War* —————
- 1986 Tax Reform Act signed by President Reagan, and the IRS begins offering limited electronic filing
- 1998 IRS Restructuring and Reform Act of 1998 establishes the Taxpayer Advocate Service
- 2003 More than 40% of individual tax returns filed electronically

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