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An exploratory study of economic incentives and corporate tax evasion

How can economic incentives to self-report reduce corporate tax evasion in Norway?

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Foreword

This thesis concludes my Master of Science in Economics and Business Adminstration at the Norwegian School of Economics (NHH), and is the result of my acquired knowledge at NHH.

Writing the thesis has been a trial, but I am happy and proud to present my final assignment at NHH. I am grateful for the fantastic support and feedback from my supervisor, Tina Søreide, and her PhD candidate, Kasper Vagle. The two of you have been invaluable, and I never would have done this without you. Thank you.

A particular thank you to the anonymous interviewee from Skatteetaten for offering priceless insight into law enforcement. Without your devotion and knowledge, this thesis would be something else entirely. Your help has been superb.

In addition, I would like to thank Marianne Bender and Elisabeth Frankrig from Økokrim for agreeing to an interview; my contact person in Skatteetaten, Kari Heggstad; and, Bjørn Erik Egaas and Lasse Aanstad from the legal department in Skattedirektoratet for answering several questions over email. Finally, I would like to thank Skatteetaten and the Norwegian Centre for Taxation for the financial support, and the opportunity to present my thesis at Skatteetaten's office in Bergen.

Jonas Hvaal Christensen, Bergen, May 2019.

Abstract

The thesis aims to answer how economic incentives to self-report can reduce corporate tax evasion in Norway. To do so, I make a theoretical and empirical comparison, using a literature review and interviews with Skatteetaten and Økokrim. In addition, I examine corporate instruments to prevent corporate tax evasion in the first place. The findings suggest that tax amnesties, or leniency programs, are inadequate to induce corporations to self-report tax evasion. Instead, I argue that whistleblowing programs and individual bounties can induce employees within noncompliant companies to self-report the misconduct. The use of rewards is untraditional in Norway and it would require substantial efforts to achieve a culture in favour of whistleblowers, which could effectively combat corporate tax evasion.

Key words: self-report, leniency programs, tax amnesty, corporate tax evasion, whistleblowing, corporate and individual liability, rewards, corporate prevention and policing.

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1. Introduction

An economic incentive to self-report is a carrot offered by the authorities in exchange for bringing forth evidence of misconduct. For example, leniency programs offer penalty reductions in exchange for information about a cartel.[1] Under competition law, which exists to promote competition and protect the interests of consumers (Lovdata, 2017), self-reporting is an established practice firms can utilise to receive a lenient treatment. Competition Act § 10 prohibits cartel activity, and the Norwegian Competition Authority, Konkurransetilsynet, deals with breaches of the competition law.

In 2005, Konkurransetilsynet was given the power to offer full or partial leniency to the first agent who reports an infringement of § 10. The leniency program is subject to the civil system only, and is exclusive to breaches of § 10, with no connection to the Penal Code (Eriksen & Søreide, 2012). According to Konkurransetilsynet (n.d.), the agency can impose violation charges up to 10 percent of the firm's annual turnover. In addition, individuals can be held liable and receive fines or imprisonment up to 6 years. Other penalties include negative publicity and reputational damage, and debarment from future contracts. For example, in 2013, Konkurransetilsynet fined NCC Roads AS NOK 140 million for cartel activity. The reporting agent, Veidekke AS, received full leniency and avoided the NOK 220 million penalty (Konkurransetilsynet, 2013).

According to Eriksen and Søreide (2012), leniency programs' short- and long-term objective is to effectively expose cartels and reduce the prosecutional expenditure, and prevent cartel participation, respectively. The literature suggests that if the programs are structured well, and provide sufficient incentives, cartel participants will self-report. The evident success of incentive policies in competition law against cartel activity (see Section 1.1) became the foundation of this thesis. Can economic incentives address other corporate crimes? For example, can the lesson learnt from competition law support tax enforcement to deter corporate tax evasion? Although there are many forms of economic incentives, this thesis is limited to focus on leniency programs and whistleblowing. The objective of the thesis is to answer the following research question:

[1] A cartel relates to a collusive agreement between independent parties with the intention to promote a mutual interest, e.g. fix prices to increase profits. Cartels are made illegal because they restrict competition and reduce social welfare. (European Commission, 2017; Konkurransetilsynet, 2018).

"How can economic incentives to self-report reduce corporate tax evasion in Norway?"

The subject of economic incentives, self-reporting and corporate tax evasion remains in its infacy as it pertains to literary analysis. Notably, leniency programs refer to tax amnesties in the tax literature. In addition, much attention has been allocated to corporate instruments as a cost-efficient method to deter and handle cases of corporate crime. Although corporate prevention does not directly relate to self-reporting, it receives ample interest because it has the potential to deter corporate tax evasion in the first place, and accordingly so, deserves noteworthy notice in a thesis that with any luck can support tax enforcement.

The thesis contributes to the literature by examining a selective literature on economic incentives and corporate tax evasion, and builds a bridge between them. To assess what should be done to incentive corporations to self-report, I conducted a thorough literature review of the economic incentive policy from competition law. The literature is compared with the tax enforcement's approach to dealing with corporate tax evasion in Norway. The intention is to determine the synchronisation between what should be done, and what is done. The study of Norwegian tax enforcement is based on interviews with Skatteetaten and Økokrim, the tax authority and the economic crime unit, respectively. I interviewed one representative from Skatteetaten (henceforth "the Subject") in Bergen, and held an informal conversation with two representatives from Økokrim in Oslo. The latter mainly provided background information at the beginning of the thesis.

The thesis is structured as follows. Part 2 presents the world of tax evasion, with an emphasis on regulations, enforcement agencies and the motivation behind corporate tax evasion. Part 3 introduces the related literature and the respective theories of Arlen (2011), Spagnolo (2005) and Aubert et al. (2004). Part 4 discusses the methodology. Part 5 analyses the application of the theory against the data on empirical law enforcement, a theoretical and empirical comparison. Part 6 concludes and suggests future research areas.

1.1 Leniency programs: background

The academic interest in leniency programs in cartel matters spiked around the early 2000s in what Giancarlo Spagnolo (2006) refers to as "*the leniency revolution*".[2] It began with the United States (U.S.) Department of Justice's (DOJ) fresh leniency policy – the Corporate Leniency Policies – in 1993. Prior to the 1993 reform, the original U.S. Corporate Leniency Program, introduced in 1978, received no more than a single leniency application a year. The original policy did not provide self-reporters with automatic amnesty, and the lack of predictability made the tool inefficient (Hammond, 2009). Additiontally, technological advances and improved global transparency may have led to a more open society that uncovers illicit activities, e.g. Panama Papers. For instance, countries that have committed to the OECDs Common Reporting Standard (CRS) allow an automatic exchange of information between members concerning assets held abroad and the taxes that taxpayers owe their respective countries.[3]

The revised policy improved program transparency and predictability for companies willing to cooperate with the DOJ. Three major aspects were reformed. First, spontaneous self-reports, i.e. reports given before any investigations had begun, were rewarded with an automatic amnesty given that the corporation met the requirements of the program. Second, an alternative amnesty was created for cooperation after the investigations had begun, which was not equally appealing. Third, all directors, officers and employees who came forward with the firm and agreed to cooperate also received automatic amnesty if the corporation qualified. The effect of these changes resulted in a twenty-fold increase in the number of applications and fines levied, and brought down various international cartels (Hammond, 2009). The success of the program led numerous countries and the European Union (EU) to include similar policies (OECD, 2002).

[2] However, leniency policies are nothing new under the sun. In fact, it is an ancient principle to receive a milder punishment in exchange for valuable information. For example, Julius Cesar, the Nazis and Saddam Hussein have all used similar concepts to weaken alliances and obtain valuable information about the opposition (Spagnolo, 2006).

[3] Norway has entered into agreements with other countries regarding automatic exchange of information about financial accounts to improve the financial transparency and defeat tax evasion and international tax crime. This implies Norway receives financial information about Norwegian taxpayers' wealth in foreign financial institutions from foreign authorities. Examples of such agreements are the OECD's CRS, which include 100 countries, and the U.S. Foreign Account Tax Compliance Act (FATCA)(Skatteetaten, n.d.). Økokrim representatives agreed that an exchange of information between countries could be preventive, and for example result in more individuals reporting hidden wealth abroad.

In 1996, the European Commission (EC) introduced its own leniency program. Again, poor predictability restricted the success of the program. Only 16 applications for leniency were filed between 1996 (of which 3 were granted amnesty) until the program was revised in 2002. In comparison, once automatic amnesties pre-investigation were introduced, 20 applications for leniency were filed the following year alone (Spagnolo, 2006). Evidently, if given sufficient incentives to come forward, agents will do so. The revised policies are rightfully considered a success because of the improved figures.[4] Transparency and predictability is one of Anderson and Cuff's (2011) pillar stones for a successful leniency program, which the figures following the reforms support.

For example, in the U.S., eligible corporations and individuals can avoid criminal prosecution, fines and imprisonment by self-reporting the cartel and collaborate with the authorities (DOJ, 2018). A firm can receive lenient sanctions by pleading guilty if it fails to qualify for full immunity (Spagnolo, 2006).[5] On the other hand, in the EU, self-reporting firms may receive an amnesty if they qualify, or partial immunity from fines by presenting evidence that adds significant value (European Commission, 2019a).[6] Similarities between the U.S. Leniency Policies and the EU 2002 Leniency Notice include automatic, full amnesty to the first reporting agent (first-come principle); not-first reporting-agents are eligible for lenient treatment; and, benefits are substantially greater before an investigation has begun.[7]

[4] Hoang's et al. (2014) study suggests that the EU 2002 reform improved the incentives to self-report. They also find that an increase in fines results in greater incentive to self-report a cartel.

[5] A plea bargain implies the defendant receives an offer to plead guilty to a crime, and in return, receives a lesser sanction. The OECD Policy Brief (2008) discusses whether plea settlements undermine leniency programs. Corporations may be discouraged to come forward and collaborate through leniency if plea settlement discounts are too large. In the U.S., the remaining firms may reduce their fines by pleading guilty and cooperate. The settlement option is available to all at any given time during the investigation, and earlier settlements and collaboration yield greater penalty discounts.

[6] According to the European Commission (2019a), the penalties imposed on companies that violate the competition law can be severe. For example, a truck manufacturer cartel in the EU operated for 14 years until one participant applied for a leniency program and received a full amnesty. Thus, the reporting agent avoided a €1.2 billion fine. The total fine sanctioned on the cartel was €2.93 billion. Most of the remaining participants also received a penalty discount for their cooperation. See http://europa.eu/rapid/press-release_IP-16-2582_en.htm.

[7] Konkurransetilsynet offers leniency to self-reporting agents. Only the first reporting agent receives a full amnesty provided they continue to collaborate with the authority. Nor will the authority criminally prosecute the agent if all criteria are satisfied. The second, third and others can apply for a partial amnesty of 30-50 percent, 20-30 percent, and 0-20 percent, respectively (Konkurransetilsynet, n.d.). See https://konkurransetilsynet.no/lempningsordningen-du-kan-unnga-gebyr-og-straffeforfolgning/ (in Norwegian).

In tax matters, a leniency program is referred to as a tax amnesty. In Norway, an amnesty is a voluntary correction of taxes where the taxpayer's violation is forgiven in exchange for self-reporting and rectifying the transgression, i.e. a cancellation of fines, a full 100 percent leniency program.[8] This implies that no surtaxes are imposed on the taxpayer, nor is he prosecuted. Yet, the taxpayer must repay the owed taxes with interest. Tax amnesties are meant to benefit both the taxpayer and the government, but that is not necessarily the case. Alm, McKee and Beck's (1990) findings suggest compliance can either decrease or increase following an amnesty, subject to the post-amnesty enforcement actions. Malik and Schwab (1991) find that if the likelihood of an amnesty increases, taxpayers report less income, and Stella's (1991) findings indicate amnesties are unlikely to collect additional taxes. Alm and Beck (1993) used a time series analysis to determine the long run effect of a one-time Colorado amnesty program followed by greater tax enforcement. They concluded that the amnesty had no effect on the amount or trend of collected tax. Evidently, amnesties may not yield the intended benefits. Section 2.1.1 and 5.1.1 discuss tax amnesties in further detail.

1.2 Description of concepts

Appendix 8.1 offers a description of concepts used in the thesis.

[8] See https://www.skatteetaten.no/rettskilder/type/handboker/skatteforvaltningshandboken/gjeldende/kapittel-14-administrative-reaksjoner-og-straff/ID-14-4.001/ID-14-4.002/#frivillig (in Norwegian) for a detailed explanation of "voluntary". If a taxpayer expects control measures or reports after the authority has begun an investigation, it will not be considered a voluntary correction and the taxpayer is not eligible for an amnesty.

2. Tax evasion and relevant regulations

Section 2.1 introduces the relevant tax regulations and governmental agencies. Section 2.2 shows the extent of tax evasion and that it is a serious social problem. Section 2.3 investigates corporate tax evasion, and who benefits and commits it. Finally, Section 2.4 considers the basic differences between cartel activity and corporate tax evasion.

2.1 Skatteetaten, Økokrim and tax regulations

Tax evasion, or tax fraud, is defined as evasion of different types of taxes, e.g. net wealth or income tax, from the state. The offence involves disclosing incorrect or incomplete information, or not disclose at all, which yields a tax advantage (Økokrim, 2017a). In comparison, the IRS (2017) defines tax fraud as "*an intentional wrongdoing, on the part of a taxpayer, with the specific purpose of evading a tax known or believed to be owing*".[9] That is, a taxpayer utilises illegal means with the intent to cheat the government of legally owed tax revenue. Typical illegal means include understating taxable income, overstating acceptable deductions or not reporting wealth held at foreign financial institutions (FFIs).

Paying taxes is a legal responsbility of all taxpayers in a society, and in Norway the Tax Administration Law § 8-1 states that a taxpayer is legally obliged to disclose the correct and full information. Failure to do so may result in surtaxes in accordance with § 14-3. Surtax is a civil sanction imposed on the taxpayer. The size of the surtax is 20 percent of the tax advantage. However, in deliberate or grossly negligent cases, Skatteetaten can impose a sharpened surtax equivalent to 40 percent of the tax advantage, in accordance with § 14-6 (Lovdata, 2019). In tax matters, the civil track is Skatteetaten's domain, who is responsible for upholding tax compliance and enforce breaches of the Tax Administration Law.

On the other hand, Økokrim handles criminal cases. A criminal prosecution in tax cases implies a violation of the Penal Code §§ 378 to 381 where the taxpayer has disclosed incorrect or incomplete information, which yields a tax advantage. Criminal sanctions are

[9] Økokrim representatives expressed in general that the investigation seeks to clarify if the objective terms in the penal provision and the criterion of guilt is fulfilled. In other words, the *mens rea*. In complex economic crime cases, which often include investigations abroad, this is often both time and resource consuming.

fines and imprisonment up to 6 years, however the size of the fine is not addressed.[10] It is the extent of criminal intent, or *mens rea*, that separates surtax, sharpened surtax and tax evasion.[11] For example, a recent case involving E&P Holding AS and TGS Nopec Geophysical Company ASA resulted in a NOK 85 and 90 million fine, respectively, and two executives were sentenced with 5 years, and 3 years and 10 months imprisonment. The amount of tax evaded was NOK 291 million (Økokrim, 2019). Corporate penalties in the form of fines are imposed since corporations are intangible bodies that can not be imprisoned. If the defendant approves the fine, it will save the state resources, and as a reward, the defendant receives a discount. Originally, a NOK 85 million fine was imposed on both E&P Holding AS and TGS Nopec. By not accepting the fine, the fine increased to NOK 90 million. E&P Holding approved the sanction and was granted a NOK 5 million discount, TGS did not approve the fine and was fined a corporate penalty of NOK 90 million in the criminal case.[12]

The thesis focuses on corporate tax evasion, described as failure to pay or underreport legally owed corporate income tax by Slemrod (2007). For simplicity, I assume income tax evasion, a direct tax imposed on corporations income. Failure to uphold this responsibility is punishable with substantial penalties and possibly imprisonment. Corporate tax compliance is important to the fiscal sustainability of the government, and Figure 1 shows the various taxes collected in Norway, based on 2016 numbers. Although direct income tax from individuals is the largest share of the pie chart, *"taxes on profits, VAT and sales taxes, income tax withholding, and employment taxes are collected or paid by business"* (Joulfaian, 2000; 2009). As such, corporate tax compliance involves more than simply the direct corporate income tax collected, and is a major contributor to the Norwegian state.

[10] The size of the penalties imposed on noncompliant firms must be sufficiently large to remove profits from crime. The Penal Code § 27 addresses corporate fines, and states that when a violation has occurred on behalf of the company, the company may be fined, yet it does not determine the size of the fine. The Ministry of Justice presents a report that looks into legislations relative to corruption and corporate sanctions in January 2020. One point considers whether a more detailed guideline should be introduced for imposing fines on corporations, including provisions for calculating the amount of the fine (Regjeringen, 2018).

[11] Additionally, according to Arlen (2011), the three main differences between civil and criminal sanction in a corporate context relate to i) a higher burden of proof for criminal cases, ii) the magnitude of the fine, and iii) debarment and de-licensing.

[12] All the defendants have appealed against the sentence, and it is therefore not legally binding.

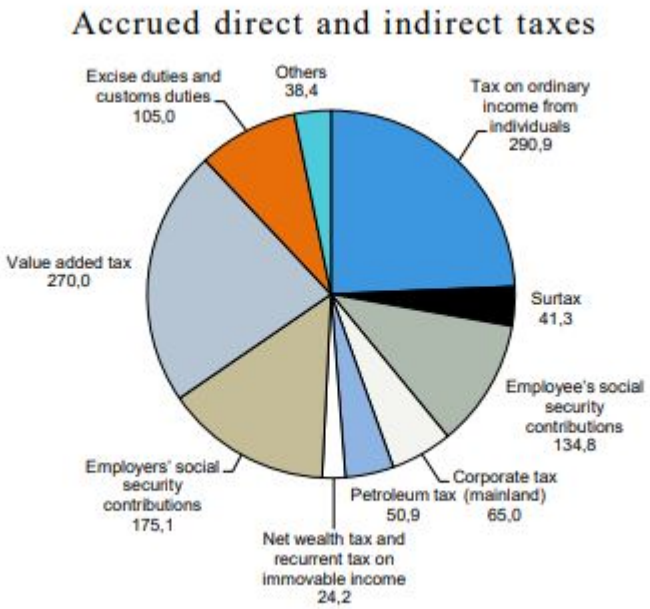

Figure 1: Accrued direct and indirect taxes estimates for 2016. In NOK billion (Ministry of Finance, n.d.).

Skatteetaten is the tax authority in Norway and is subject to the Department of Finance. The agency aims to finance the welfare state. In order to do so, Skatteetaten is responsible to maintain an up-to-date population register and ensure that the correct amount of tax is established and collected in an appropriate manner. The director of Skatteetaten emphasises the difference between a society where each and everyone pay their dues, and a community that relies upon sanctions and punishment to collect taxes (Skatteetaten, n.d.). Trust and confidence in the citizens are at the core of the tax system. The Supreme Court has announced the importance of large sanctions to penalise violators and frighten potential wrongdoers. The majority of cases where the trust is broken originates with Skatteetaten. I conducted an interview with one representative from Skatteetaten.[13]

Predominantly, Skatteetaten detects corporate tax evasion through audits and investigations. The literature supports that standard deterrence policies such as fines and audits increase compliance (Litina & Palivos, 2016; Hoopes et al., 2012; Badara, 2012).[14] Because audits

[13] The Subject has substantial experience with tax amnesties but wishes to remain anonymous to discuss personal opinions openly. For simplicity, the Subject will reflect my own gender, and be referred to as either he or his. This terminology generally applies throughout the thesis for no other reason than it feels more natural to me personally.

[14] Gangl's et al. (2014) findings suggest that close supervision of newly started high risk companies crowds out intrinsic tax compliance values, which results in delayed tax payments. This can imply that too much supervision could have an adverse effect on compliance.

require resources, whereas fines signal about greater expected costs, the latter is favoured as a more cost-efficient deterrence tool.[15] Generally, most law enforcement relies on punishment risk to deter crime. The Subject said risk analyses by firms have a preventive effect since most firms pay the correct amount of tax.[16] Resource restrictions force Skatteetaten to be selective when deciding what industries and companies are audited, a decision determined by a team of analysts. For large corporations, an income determination is forecasted and closely followed-up with an open dialogue with the companies. The most complex and severe cases are passed along to Økokrim.

Økokrim (the National Authority for Investigation and Prosecution of Economic and Environmental Crime in Norway) is the leading unit within the police and prosecution team to fight economic and environmental crime. As such, the most extensive cases are brought to Økokrim. Predominantly, Økokrim deals with criminal cases, whereas civil matters are dealt with by other agencies such as Skatteetaten (Økokrim, 2017b). That is, cases are reported to Økokrim when criminal sanctions are due. I held an informal conversation with two representatives from Økokrim to collect some background information.[17] More information about the meetings with Skatteetaten and Økokrim are given in Section 4.2.

2.1.1 Amnesties

Amnesties pardon wrongdoers and collect resources, e.g. library books or tax revenue, that in the absence of an amnesty would not be recovered. Tax amnesties allow a taxpayer to voluntary correct his taxes and avoid surtaxes and criminal prosecution (Leonard & Zeckhauser, 1986; Baer & Le Borgne, 2008; Skatteetaten, n.d.).[18] In other words, a full amnesty is a 100 percent penalty reduction. Bayer et al. (2015) propose that policymakers

[15] Kuchumova (2017) looks into an alternative enforcement tool than auditing. Namely information reporting, which allows the tax authorities to verify a tax return against a taxpayer's information from a third party. She argues that this approach facilitates for more efficient audit targeting. She also finds that the optimal audit coverage increases in accordance with the enforcement budget

[16] See Posner (2000) for a discussion about tax compliance and social norms. Culture has a strong influence on compliance.

[17] One senior public prosecutor in charge of the TGS-Nopec case, and a police attorney who is acting team leader for the tax team.

[18] Amnesties can relieve previous delinquents of their guilt and improve medium to long-term compliance because past evasion forces individuals to continuously manipulate taxes to cover their tracks. A clean slate allow them to continue as law-abiding citizens. Leonard and Zeckhauser (1986) find that previous wrongdoers who are overcome with guilt are the most effective target group for amnesties because they suffer when no one else benefit.

consider amnesties helpful to increase short-term revenue, which is why they have become particularly popular during economic downturns. Skatteetaten frequently utilises tax amnesties, and the amnesty scheme has collected an additional NOK 1,5 billion in taxes over the recent years (Skatteetaten, n.d.). However, the usual amnesty applicants are individuals, and not corporations. A topic that is revisited in Section 5.1.1.

In theory, amnesties appear to be helpful, however, Baer and Le Borgne (2008) claim the empirical benefits of amnesties are misguided. They propose that amnesties could lead to lower tax compliance because tax amnesties are a legal escape route for violators that lowers the expected cost of the crime.[19] If taxpayers expect a future amnesty, it could be optimal to be noncompliant today, which strengthens the government's need for an amnesty to make up for the loss in revenue (Bayer et al., 2015). For example, India offered a tax amnesty on 7 different occasions over a period of 35 years period. This signals an inability to effectively enforce taxes, and lowers public faith in the tax system (Bird, 2014). In addition, Baer and Le Borgne (2008) claim cost and benefit measures of amnesties are misleading since some costs are difficult to quantify, e.g. public faith in the system.

To emphasise their concern about future amnesties, Baer and Le Borgne (2008) enquire "*why return any library book now if you can keep it* [for] *free until the next amnesty?*", and suggest that to mitigate this effect, amnesties should be a one-time-only basis.[20] However, such a strong commitment may be unrealistic since *"if it made sense once, why will it not make sense again?"* (Leonard & Zeckhauser, 1986). For example, the U.S. has granted draft amnesties after every war, so why join the draft if you can predict a future amnesty?

Therefore, tax amnesties must be accompanied with sufficiently high fines to discourage waiting until the next amnesty and uphold the faith in the system (Baer & Le Borgne, 2008). Many pay their taxes because they believe it is the right thing to do, and that evasion will be detected.[21] The introduction of amnesties could signal that evasion is an insignificant and

[19] Arlen and Kraakman (1997) argue that a bribery offender should not receive full leniency because this would imply the offender can take bribes with no risk as long as the violation is reported afterwards. Similarly, tax amnesties can have adverse effects if they are constantly available because taxpayers can commit tax evasion with a low risk of being sanctioned.

[20] Bayer et al. (2015), suggest a commitment mechanism, e.g. a legislation, that credibly commit governments not to endorse amnesties. They propose tax compliance should improve as long a citizens are aware of the legislation and the government's commitment not to enact amnesties.

[21] Frey (1997) suggests taxpayers uphold their responsibility to pay taxes due to their extrinsic- and intrinsic motivation. For example, because taxpayers worry about sanctions for tax evasion and that they are willing to contribute to public welfare,

forgivable violation. As a result, voluntary compliance may drastically decline in the short- and long run.

2.2 The effect of tax fraud – pocketing the state

Taxpayers frequently ignore the risk of detection and choose to evade taxes.[22] In fact, history reveals that citizens and corporations can not be trusted to pay their due taxes, which is why tax payments have become a legal responsibility.[23] Based on 2001 numbers from the Internal Revenue Service (IRS)[24], corporate- and individual underreporting amounted to $30 billion and $149 billion, respectively. That same year, the underreporting rate for corporations and individuals were 17.4 percent and 13.8 percent, respectively (Slemrod, 2004). According to 2011 numbers from Skatteetaten, 6 of 10 corporate entities paid no tax, and the evaded corporate income tax totalled NOK 29 billion (NRK, 2013).[25] Furthermore, Joulfaian (2000) found that 72.1 percent of the medium-sized corporations in his study failed to comply, and that they understated their income, on average, by roughly a third.

Tax evasion is a social concern because it implies a loss of revenue for the state, which increases the national debt and weakens the government's ability to provide public services. It is difficult to determine the extent of tax evasion in a given country due to it's secrative nature. However, the tax that the state is meant to collect and what it actually collects, "the tax gap", provides a rough estimate of a country's (non)compliance.[26] In the U.S., the

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respectively. The use of tax amnesties could also reduce the fear of being caught and fined, which could reduce tax compliance.

[22] Note the important distinction between tax evasion, i.e. illegal tax evasion by e.g. underreporting earnings, whereas tax avoidance refers to the use of legal means, e.g. exploit legal loopholes, to reduce tax payments. Sandmo (2004:4) writes that the difference between evasion and avoidance "*hinges on the legality of the taxpayer's actions*". Lipatov (2012) argues that in reality, the difference between the two is "*virtually impossible to distinguish*". A large legal grey area allows different interpretations of the law, which complicates the cases further.

[23] Slemrod (2007) explains how the Romans used to hide their wealth by burying their jewelry in order to pay less luxury taxes. Similary, there is a Norwegian saying "å ha svin på skogen", which implies you have something to hide. The origin stems from older times when farmers would hide pigs in the forest when the tax man came, also to hide their wealth.

[24] The IRS belongs to the U.S. Department of the Treasury and is responsible for taxation and the enforcement of tax law. It is considered to be one of the world's most efficient tax administrators, spending 35 cents for each $100 collected in fiscal year 2015 (IRS, 2019).

[25] Notably, the then-director of Skatteetaten was not surprised that the majority paid no taxes, as many firms, especially start-ups, have no profit. Nonetheless, he claimed the extent of tax evasion in Norway is worryingly high (NRK, 2013).

[26] The three components of the total tax gap are underreporting, nonfiling and underpayment (Crocker & Slemrod, 2004). Although there are numerous definitions of the tax gap, all relate to loss of revenue due to noncompliance (Gemmell &

average gross voluntary compliance rate was 81.7 percent across the 2008-10 period (IRS, 2018). Per 2015, there was no estimate of the tax gap in Norway (Skatteetaten, 2015), nor have I found a tax compliance estimate.[27] However, a Swedish study by Skatteverket in 2007 established a tax gap estimate and concluded that the size of the tax loss imposed on the Swedish state amounted to approximately 5 percent of gross domestic product (GDP). Alternatively, 10 percent of the stipulated tax (Skatteverket, 2008). If applied to the Norwegian GDP, it implies a tax loss equivalent to ca. NOK 165 billion. When enquired about the Norwegian tax gap, the Subject was uncertain yet said NOK 150 billion, but that this figure has to be taken with a grain of salt. A more recent estimate of the full shadow economy in Norway, of which tax crimes are only a part, is 12.6 percent and equivalent to ca. NOK 415 billion (Schneider, 2016). In comparison, IRS' (2018) most recent estimate of the U.S. tax gap shows a gross average of $458 billion over the period 2008-2010, an increase from 2006.

Furthermore, tax compliance reflects the relationship between citizens and the state. For instance, Norway is an unique case where political parties can run a campaign on increased taxes. In comparison, U.S. elections have a tendency to resolve around tax reductions. A possible indication is that Norway is a high trust society that believes taxes are repaid through improved public welfare, whereas U.S. citizens distrust the administration and maintain little faith in the government's ability to reallocate the tax revenue to society.[28] In order to safeguard taxpayer's faith and fairness of the tax system, a high compliance rate is necessary because honest taxpayers are burdened with the dishonest taxpayer's evasion.

Hasseldine, 2012). The IRS' Tax Compliance Measurement Program (TCMP) is the basis for most tax noncompliance estimates. TCMP is a series of random audits of tax returns between 1960s until 1988 (Hanlon et al., 2005).

[27] Skatteetaten (2015) discusses how the Norwegian tax gap can be calculated, but offers no estimate. The conclusion is that calculating an estimate would be extensive and resource demanding.

[28] Both Hanousek and Palda (2004) and Torgler (2003) support that greater trust in the government has a positive effect on tax morale and compliance. The former find that a 20 percent rise in perceived quality of government services could result in a 13 percent reduction of the frequency of tax evasion in the Czech and Slovak Republics, and other transition countries. Moreover, Skatteetaten (2013b) supports that if the government experiences great trust from the public, the public will have a higher tax moral. Pickhardt and Prinz (2014:14) propose that "*[t]rust is the main ingredient for cooperative tax behavior"*, and that if tax authorities distrust taxpayers, taxpayers appear to distrust tax authorities.

2.3 Who commits corporate tax evasion?[29]

Much research on tax evasion is based on the Allingham and Sandmo (1972) model for individuals.[30] However, there is scarcer literature about the motivation behind corporate tax evasion.[31] Marrelli (1984) extended the A-S model to study *ad valorem* tax and indirect tax evasion.[32] However, the A-S framework is arguably inadequate for direct corporate tax evasion. Alternatively, when ownership and control are separate, the contractual relationship between the shareholders and the manager could shed more light on corporate tax evasion. Chen and Chu (2005) and Crocker and Slemrod (2004) has researched this. Sandmo (2004) wrote that their results had no counterpart in previous literature and offered a promising new area of research.

First, it is important to understand what motivates corporate tax evasion. The Subject stressed that it is vital to distinguish between small-medium and large corporation when incentives are explored. Small-medium corporations generally have a smaller distinction in control/ownership than larger companies do. If the owner is also the decision maker in terms of taxation, he stands to directly gain from the crime and hence, has an incentive to commit the crime.[33] On the other hand, in multinational companies, employees' personal gain is more ambiguous relative to smaller companies. The Subject suggested that employees in large companies are not necessarily aware that they do not direct gain from committing corporate crimes. Instead, he proposed that large corporations evade taxes because there is a culture where tax is considered an expenditure that should be minimised. In terms of involved agents, the Subject claimed that it is typically one person who runs the scheme, but that it is difficult to hide this from other employees who actively engage in the company.

[29] Some form is tax evasion is assumed through error etc., this paper focuses on the intentional choice to commit tax evasion.

[30] The traditional tax evasion model for individuals by Allingham & Sandmo (1972) relates the economic crime model by Becker (1968) to tax evasion. They discuss the optimal level of tax evasion given by the expected cost (penalty and probability of detection), the individual's level of risk aversion and the benefit of evasion.

[31] Chen and Chu (2005) wrote that one possible reason why corporate income tax evasion was not researched more extensively could be because *"… the conceptual difference in the evasion decision between an individual and a corporation is hard to capture analytically."*

[32] Ad valorem tax is based on the assessed value of the taxed item. The word itself means "according to value", which creates the basis for the amount of tax levied. However, this will not be paid any further attention.

[33] Kamleitner et al. (2012) investigate tax compliance of small business owners and find that relative to employed taxpayers, small business owners see more opportunities for noncompliance and face decsisions where taxes are considered a loss. Both could induce tax noncompliance.

Naturally, this is subject to the size of the company, and many employees may be indirectly involved in the sense that they are not aware of the scheme, but assist its sustainability.

Joulfaian (2000) wrote "*[c]orporations, as fictitious entities, do not cheat on their income tax returns: their managers do"* as he studied the correlation between corporate income tax evasion and managerial preferences. He found that noncompliant corporations are three times more likely to be managed by executives with a preference for personal income tax evasion.[34] Joulfaian (2000) excluded big multinational enterprises with a large difference between ownership and control. This separation implies the owner's power to influence the size of the income gap is weaker relative to a medium-sized corporation where the owner may exert more influence on the daily operations. This is in accordance with the arguments by Arlen (2011), who states that in terms of corporate crime, the corporation is the primary beneficiary from a crime, not the footsoldiers of the company. Thus, a logical assumption to make is that corporate income tax evasion is more prominent where the owner is actively engaged in the company.[35] In fact, Joulfaian (2000) found evidence that as companies grew in size, they experienced less noncompliance.[36]

Yet, large corporations do experience noncompliance.[37] The scare literature about the motivation behind corporate tax evasion that do exist attempts to use a principal-agent approach that builds on the A-S model. For example, Chen and Chu (2005) investigate a situation where an agent (a manager) is hired by the principal (the shareholders) for the sole

[34] Joulfaian (2000) proposes his result implicates that the tax authorities should implement a joint examination of the corporation's tax returns and the managers' personal tax returns to uncover noncompliant corporations.

[35] Joulfaian (2000:699) wrote that "[l]*arge firms are more likely to be decentralised and provide for greater separation between ownership and control, which may weaken the owner's ability to influence the size of the income gap."*. Therefore, the owner has greater incentive to commit corporate crime, e.g. tax evasion, and the power to influence the income gap in a small to medium enterprise (SME). Slemrod (2004) argues that small firms tend to behave like an individual in terms of tax decisions, which supports that managerial preferences can strongly influence the tax compliance of small companies.

[36] DeBacker et al. (2015a) state that in larger firms, the influence of corruption norms fall, which they claim is in contrast with Joulfaian's (2000) results that the influence of managerial preference "*did not vary with firm size*" (Debacker et al., 2015a:136), which leads them to the conclusion that as companies increase in size, the influence of owner's weaken, whereas manager's influence does not. Their explanation is that Joulfaian (2000) focuses on the manager, although he clearly refers to ownership in footnote 35. It is possible that Joulfaian uses owner and manager interchangably for a medium-sized enterprise. To me, they seem to find complimentary results.

[37] Hanlon et al. (2005) find that the corporate tax noncompliance rate in their study is 13 percent (similar to IRS tax gap estimates), and that very small businesses exceed this rate. Additionally, they propose that "*noncompliance is generally a progressive phenomenon, meaning that noncompliance … increases with the size of the company"*. Thus, Hanlon et al. (2005:27) conclude that "*business tax noncompliance relative to scale is U-shaped, with medium-sized businesses having the lowest rate of noncompliance*", which contrasts Joulfaian's (2000) findings. A possible explanation could be that Hanlon et al. include aggressive tax avoidance in "noncompliance". With more foreign operations and a more complex organisational structure, it is possible large firms are more prone to pursue this strategy.

purpose to evade taxes on their behalf. They argue that the Allingham and Sandmo's (1972) model can not be applied to explain the evasion behaviour of corporate managers because corporate tax evasion is far more complicated than the individual equivalent (Chen & Chu, 2005; Lipatov, 2012). One reason, as shown by Chen and Chu (2005) is that corporate tax evasion requires involvement of more than one person and cooperation between members in a corporate hierarchy. Thus, it is unlikely that a single individual can solely sustain a tax evasion scheme.

In addition, Crocker and Slemrod (2004) investigate how the principal can structure the agent's compensation policy to encourage tax evasion on their behalf. Managers are in control of the company and have a responsibility to act in the best interest of the shareholders. Because corporate profits are negatively affected by tax, shareholders benefit from a lower tax burden. Thus, shareholders may structure the compensation policy of the Chief Financial Officer (CFO) in a way that encourages tax evasion. Accordingly, the CFO reduces the tax burden (through illegal means) to act in the best interest of the shareholders – absent any costs of doing so, including expected sanctions following detection.[38]

However, Friedman (1970:1) claims profit maximising is a responsibility held by managers as they represent the interests of the owners, but that managers has to meet their responsibility "*while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom"*. As a result, Crocker and Slemrod (2004) propose it may be more appropriate if the compensation policy of the CFO inversely depend on the effective tax rate. However, they do not offer any discussion why shareholders should structure the policy in such manner. After all, a manager that does not pursue strictly legal means to reduce the tax amount, performs poorly on behalf of the shareholders.

Another point by Crocker and Slemrod (2004) relates to the focus of corporate tax departments, which they propose has changed dramatically. Instead of being a necessary money pit that passively follow compliance, tax departments have become a centre of innovative profits through "*active, aggressive, and often arguably illegal tax planning*" (Crocker & Slemrod, 2004). This is in accordance with the previous statements made by the

[38] Reputational damage could be a possible concern of shareholders and managers, which could prevent tax evasion. However, Akhtar et al. (2017) examined the adverse short- and long-term effects of multinational corporation's (MNC) financial performance following publicity that the firm has committed, or is suspected of committing, tax evasion. They found a drop in share price at the time of announcement, but concluded that it was no long-term reputational damage influencing the profitability or value of the firm.

Subject. Additionally, Hollingsworth (2002) conducted a manufacturing survey that revealed savings, or added value, was the most cited measure used to evalute tax departments performance. Out of the 86 percent who cited savings as the chief performance measure, 63 percent claimed that tax personnel's compensation was influenced by the measure (Hollingsworth, 2002; Crocker & Slemrod, 2004). Such a policy could encourage tax evasion, and with an entire department seeking to maximise tax savings, it is unlikely that the scheme would go unnoticed.

This section's literature leads me to make the following assumptions about corporate tax evasion:

(1) The top management is involved in the scheme. This is irrespective of company size since the manager is typically the owner for small-medium enterprises, or at least the owner can extert great influence on the daily operations. For large corporations, when control and ownership differ, owners can structure the compensation policy of the manager to encourage tax evasion.[39]

(2) Irrespective of corporate size, minimum two individuals are aware of the tax evasion scheme. The literature suggests the owner(s) and the manager as a minimum. Based on the information above, it seems unlikely that a single person can operate a scheme and that everyone else remains oblivious.

(3) In addition, I assume that the corporate tax evasion occurs in-house. Owners may not necessarily be in-house, publicly-held companies illustrate such an example, but for this thesis they are part of the in-house group. External parties such as tax havens, banks and lawyers etc. are not taken into account.

2.4 Differences between cartel activity and tax evasion

The U.S. is the leading force in terms of leniency programs, hence most literature relates to the U.S. In fact, Eriksen and Søreide (2012) describe the use of leniency in Norway as a "*legal transplant"* taken from the U.S. where the concept is considered a success. However,

[39] The Sarbanes-Oxley bill was passed in 2002 to improve the enforcement of current tax law in the U.S. Among other things, the penalties for noncompliance increased and the top management (CEO) is required to approve and sign the firm's financial statements (DeBacker et al., 2015a). This also suggest that the top management would have to be involved in the scheme. The bill also introduced stringent sanctions towards executives, which Crocker and Slemrod (2004) found to be more effective than sanctions imposed on the shareholders.

because something works in a justice system, does not imply that it automatically works elsewhere. Therefore, the implementation process can prove difficult.[40] Similarly, with a focus on leniency programs from cartel literature, which I relate to corporate tax evasion, this too will be a transplant from one framework to another where laws and institutions differ.

Law enforcement predominantly relies on audits and investigations to detect cartels and tax crime, and fines are used as a preventive tool to discourage the crimes. But perhaps leniency programs can assist law enforcement to uncover additional crimes using less resources. Both corporate crimes are unlikely to go unnoticed within the company, and the idea is that if a rational agent is offered sufficient economic incentives to come forward, then he acts in his best self-interest and reports the crime.

One main change between the crimes relates to the different agents involved, Figure 2 illustrates the relationships. For cartels, competitors decide to collude against the market and the regulatory body (blue arrows).[41] However tax evasion occurs in-house where a single firm tries to cheat the government (black arrow).

[40] For a detailed explaination of the implementation of leniency programs in Norway, see Eriksen & Søreide (2012): https://www.idunn.no/tidsskrift_for_strafferett/2012/01/lempning_for_kartellvirksomhet_og_korrupsjon (Norwegian).

[41] Ellis and Wesley (2002) found that moderate leniency programs could encourage a firm to report on a competitor to hurt their business and gain a strategic advantage themselves.

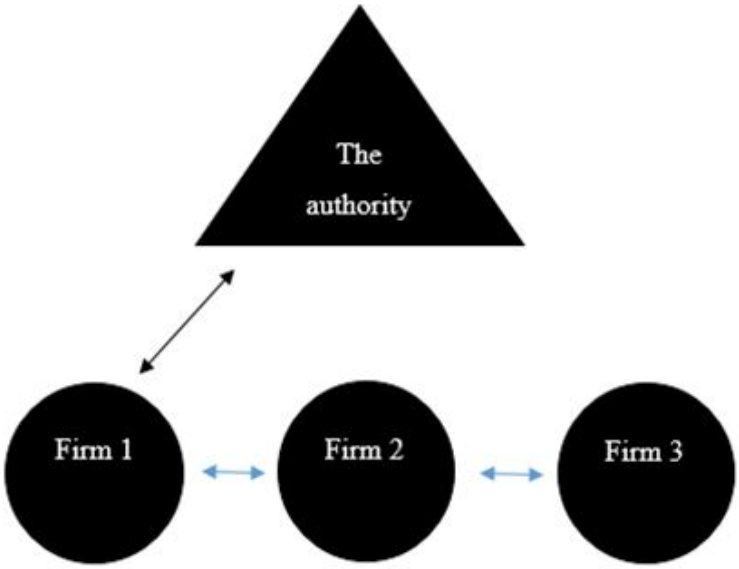

Figure 2: An illustration of the relationships between agents in collusive agreements and tax crime. The blue arrows show the cooperation between competitors in a cartel, and the black arrow shows the interaction between a single firm and the regulatory body.

Additionally, within each firm in Figure 2 are individuals that are responsible for the corporate crime in the scope of their employment. These individuals play a key role in the later discussion. Although a firm can benefit from leniency program in cartel cases, which induce self-reporting, leniency programs in tax crime does not necessarily see the same success. If we consider the cartel as a unit with particiants (namely Firm 1, 2, 3), it is possible to create distrust between the participants. Similarly, a company is a unit with participants (Employee 1, 2, 3), and perhaps it is possible to create a similar distrust, or agency cost, between the participants, which is why the individuals are particularly important in tax matters.

3. The theoretical approach

Section 3.1 provides an overview of the related literature in terms of leniency programs. Section 3.2, introduces the work by Jennifer Arlen[42] (2011; 2017) and her perspective on corporate criminal liability. Section 3.3 investigates the use of leniency programs and cartel activity based on the theory of Giancarlo Spagnolo[43] (2005). Finally, Section 3.4 discusses the work by Cécile Aubert, Patrick Rey and William Kovacic[44] (2004), a complementary study of Spagnolo (2005) that adds the concept of whistleblowers and agency costs. With the exception of the related literature, each section begins with a summary of the theory and concludes with implications for tax evasion.

3.1 Related literature

The original literature which identified the predictable benefits of schemes that incentivised violators to self-report began with Malik (1993), who found that self-reporting in terms of environmental regulations could lead to lower auditing costs. Similiarly, Kaplow and Shavell (1994) found that spontaneous self-reporting lowered enforcement costs as less investigations were required. Additionally, welfare increased with a lower number of wrongdoers, and risk-averse violators faced a much lower risk as they were eligible for an assured penalty instead of an uncertain one. The importance of a predictable sanction should not be understated. The two studies share common traits, such as investigating individual wrongdoers and single-benefit violations. As a result, both studies concluded that lower organisational costs such as auditing and enforcement could occur following self-reporting (Motta & Polo, 2003).

Subsequently, Motta and Polo (2003) extended the idea by examining self-reporting incentives with several defendants, e.g. a cartel, that participated in persistent transgressions, as opposed to individuals who benefitted once. In addition, they investigated the issue of

[42] Norma Z. Paige Professor of Law and founder and director of the Program on Corporate Compliance and Enforcement at New York University School of Law.

[43] Professor of Economics at SITE – Stockholm School of Economics and on leave from the University of Rome "Tor Vergata".

[44] Université Paris Dauphine, IDEI and Université Toulouse, and George Washington Law School and Federal Trade Commission, respectively.

deterrence that previously had not been addressed explicitly. In fact, they made the effects of legal procedures regarding cartel prevention the principal topic of their paper. They argue that monetary rewards are politically unviable, and thus exclude the possibility of a first-best result with complete and costless deterrence. Therefore, they concluded that the introduction of leniency programs is second-best. Meaning, the Antitrust Authorities (AA) is better off using fines and investigation to deter cartel activity than leniency programs, assuming they hold sufficient resources to do so, which is rarely the case.

Spagnolo (2005) assumes rewards are politically viable and his first-best result contradicts Motta and Polo (2003). Spagnolo argues that the different conclusions are explained by different assumptions. For instance, the latter utilises a model a la Becker (1968) with a single probability of detection and conviction, which complement the earlier study and allows Spagnolo to investigate the effect of leniency programs on cartels before they are investigated. Besides, policymakers determine the cost of enforcement in Spagnolo's model. In contrast, the former assumes an exogenous cost of law enforcement and conviction only with some probability.

In addition, Motta and Polo's (2003) results conflict with the DOJ's reports that state the leniency programs' success rest upon the first-come principle to create a rush to report between cartel members (Hammond, 2001), which is not a restriction in Motta and Polo (2003). According to Hammond (2001), the Amnesty Program beats all the other available investigating tools in terms of detecting and indicting antitrust violations over the previous 5 years. Roughly 50 percent of EU and U.S. leniency applications were spontaneous and qualified for the amnesty program.

Spagnolo (2005) argues that their model is designed to establish the value of Section B of the Corporate Leniency Program and if they should be allowed leniency at that point.[45] Because Motta and Polo (2003) assume conviction only with some probability, e.g. authorities might struggle to acquire sufficient evidence for prosecution, so they argue that granting lower fines are efficent for a speedier resolution and save state resources.[46] On the

[45] Section A of the Corporate Leniency Program, "Leniency before an investigation has begun", states the required conditions set out by the DOJ that corporations must meet to receive leniency before an investigation has begun. On the other hand, Section B, "Alternative requirements for leniency", shows the conditions that must be met to receive leniency before or after an investigation has begun if a corporation fails to meet the criteria in Section A. For more information, see the appendix of Spagnolo (2006).

[46] A firm is not eligible for an amnesty if at the time the evidence is brought forward, Konkurransetilsynet already possesses sufficient evidence to prove the existence of the cartel or demand a decision of proof of evidence from the court

flipside, the expected cost of collusion falls. There is a limited deterrence effect because cartels can wait until an investigation has opened to report and cartels are given an easy way out in case they are detected. So why spontaneously report?

Alternatively, Spagnolo (2005) assumes that a cartel, if detected, is conviction with a single probability. However, the probability of conviction depends on several factors, e.g. investigative resources and the corporation's collaboration, so his assumption is somewhat unrealistic. Nonetheless, his assumption makes it possible to look at the effect of leniency programs before an investigation has begun.

Moreover, Aubert et al. (2004) wrote independently of Spagnolo (2000; 2003; 2005) and obtained similar results. Additionally, they introduced the idea of incentivising employees to whistleblow and show how an informed employee can become a strong deterrence tool.

Finally, Choi and Gerlach (2012) investigate cartels that operate cross-border and introduce a theory with more than one jurisdiction and information sharing. Their findings suggest that information sharing increases the probability of detection in each jurisdiction. However, extensive information sharing could either decrease or increase the number of applications for a leniency program subject to the size of fines and probability of detection. Large fines and a high probability of detection are favoured.

(Konkurransetilsynet, n.d.). However, "sufficient evidence" implies that companies can apply for an amnesty after the investigation has begun, and there is no mentioning that a firm has to report before it begins on Konkurransetilsynet's website.

3.2 Jennifer Arlen (2011), *Corporate Criminal Liability: Theory and Evidence.*

In her paper *Corporate Criminal Liability: Theory and Evidence (2011),* Arlen suggests that the penalty discount a firm receives should depend on their implementation of corporate prevention and policing measures, i.e. what the firm has done *ex ante* and *ex post* to deter crimes. Although Arlen does not refer to self-reporting, her theory considers measures to disincentivise individuals to commit corporate crime to begin with from an economic, rational standpoint. She investigates the fight against corporate crime by examining methods to reduce the benefit and increase the expected cost of a crime for an individual (preventive measures), both of which the corporation directly control. As such, Arlen argues that the firm is the government's most efficient tool to deter corporate crime.

Naturally, firms that have implemented mechanisms to increase deterrence should be rewarded for the effort. Thus, Arlen proposes a multi-tiered duty-based sanction regime where each new layer imposes worse sanctions. The most stringent sanctions are reserved for those who fail to implement all duties: to monitor, self-report, and cooperate. Yet, firms that successfully fulfil all duties must receive a civil residual monetary fine to induce the implementation of preventive measures. Arlen (2017) advocates the use of pre-trial agreements (PDAs) to best implement her multi-tier duty based regime.[47]

3.2.1 The Simple Model

Arlen (2011) describes corporate crime as crimes committed by individuals in the scope of their employment, and that a rational employee only commits an intentional crime if the benefit outweighs the expected cost in accordance with Becker (1968). The theory considers the monetary benefits and costs of a crime. So, if an individual expects a greater monetary payoff relative to the expected costs, he commits the crime.

However, that is not necessarily true. For example, assume you find a lost wallet with NOK 200 in it. Taking the money has a very low expected cost and the benefits exceed the cost.

[47] In the U.S., prosecutors increasingly make use of PDAs instead of conviction to resolve criminal cases. There are two potential forms of PDAs: deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs). Conviction is not pursued for either DPAs or NPAs, but charges are filed by the prosecutors under the former, i.e. a formal allegation of the offense (Arlen, 2017). These tools have become associated with all areas of corporate criminal misconduct, including tax evasion (Alexander & Cohen, 2015). For a more detailed overview of PDAs, see Arlen (2017) and Søreide (2016).

Yet, many would act “irrational” and hand in the wallet to lost and found. Moral cost and culture is absent in the theory, but can significantly affect the decision making process. Alternatively, pressure from a superior could cause an employee to commit a crime although the expected costs outweigh the benefits, or the employee’s perceived job security declines if he does not accommodate the employer’s wishes. Nonetheless, I continue to assume that Becker’s assumption is correct.

Arlen (2011) shows how the state maximises social welfare if it successfully deters individual crimes and encourages optimal corporate collaboration. In her “perfect world”, corporate crime is optimally deterred using individual liability. She makes the following assumptions: (i) there are no wealth constraints for either corporations or individuals, (ii) sanctions are imposed costlessly, (iii) all parties are assumed to be rational and well-informed, (iv) contracting between individuals and corporations are engaged costlessly, and (v) the probability that the state sanctions a crime is positive ($P > 0$), even in the absence of marginal resource expenditure on enforcement. In addition, crimes are assumed intentional. Most of these are fairly unrealistic, but the model creates a foundation to build upon for an extended model.

A rational, informed and risk-neutral individual has the option to commit a crime that yields a benefit, b, to both him and society. However, society suffers harm, H, and crime is rarely beneficial to society, which generally benefits when crime rates are low. Thus, as long as $b < H$, society maximises welfare as individuals refrains from committing crimes (Arlen, 2011).

However, individuals act to maximise personal welfare and do not necessarily care about the harm to society. Absent individial criminal liability, society would be overrun by individuals committing crimes without regard for the social cost, i.e. to the individual, the payoff is $b > 0$. Thus, individual criminal liability is crucial to increase the expected cost of the crime and improve social welfare (Arlen, 2011; Becker, 1968).

To further deter crime, Arlen (2011) proposes that the state should impose a criminal fine, f, that equals the social cost, H, to hold wrongdoers accountable for the damage imposed on society. Now that society has raised the expected cost of a crime, individuals avoid the costlier crimes. She writes that the optimal fine, f^*, equals H as long as the authorities always detect and sanction all crimes ($P = 1$). In reality, however, the probability that the state detects and sanctions crimes is less than 1 ($P < 1$). Then, the expected sanction is given by Pf and the expected sanction equals the social harm to society $Pf = H$. Rearranging gives

an optimal fine equal to f* = H/P (Arlen, 2011; Becker, 1968). However, is her argument that the fine should equal the harm rational?

Arlen (2011) assumes that f = H deters crime. Although it is intuitive that an individual should face an expected liability equal to the harm caused, it makes little sense if the harm is a poor estimate of the expected gain. Rose-Ackerman (2010) suggests that instead of tying penalties with the harm/cost, it should be based on the gain. Her example states that the benefits of bribery can be an increasing function of the size of the bribe itself, e.g. a $1000 bribe yields a $1500 gain, and a $5000 bribe yields a $20,000 benefit. Then a penalty twice the size of the bribe would deter the smaller bribe but not the larger one. Thus, the penalty should be tied with the gain, not the expected cost.

Similarly, in a previous thesis, Fløytøren and Haram (2018) assume that the firm is a rational and profit-maximising entity that acts in accordance with Becker (1968). In the case of tax evasion, the benefit, B, is interchangable with the harm to society, H, because the amount of tax in question should have contributed to the benefit of society, but instead, increases the profit of the firm. Therefore, the fine should at least equal the benefit (Flytøren & Haram, 2018). In this case, Arlen's assumption would hold as f = H = B. However, the gain from tax evasion could exceed the actual tax evaded, e.g. the additional profit could have helped remove a competitor from the market, which generated more market share and profit. Overall, it makes more sense to use gain as an approximation of the expected liability. But for the sake of simplicity, Arlen's assumption is accepted as correct.

The equation f* = H/P assumes the probability P that a criminal is detected and sanctioned is fixed, e.g. a constant 10 percent. The equation states that crimes with a low P require a higher fine. Similarly, a high P implies a low fine. The authority influences P with enforcement actions, E. Allocating more resources to enforcement, e.g. undertake more frequent audits to discover tax evasion, the state can detect and sanction more crimes, P(E) > 0. This presents a discussion whether or not the state should spend additional resources on enforcement to decrease the fines. Assuming no wealth restrictions for (risk neutral) individuals and zero sanctioning costs, Becker (1968) explained that minimal enforcement expenditure minimises the crime deterrence cost. Under these assumptions, the efficient level of enforcement by the state is $\underline{E}$, where the minimum amount is spent on enforcement, and impose a fine of: f* = H/P($\underline{E}$) (Arlen, 2011; Becker, 1968).

The optimal sanction equals H/P(0), if the state's ability to detect crimes without the use of marginal enforcement costs (E = 0) remains (assumption (v)). Meaning the state undertakes no *ex ante* or *ex post* policing so P > 0, but very close to zero. Thus, f* will far exceed the social cost of the crime, H (Becker, 1968). Therefore, neither the state nor the firm, is required to spend resources on enforcement as long as this fine is feasibly imposed on the individual (Arlen, 2011).

In addition, Sandmo (2004) argues that the probability of detection and penalties are policy substitutes. Authorities may implement a high probability of detection and a low penalty, or a low probability of detection and a high penalty to achieve the same result. The latter scenario is favoured due to resource constraints. However, Sandmo (2004) supports Arlen's theory and suggests that fines will have to be unreasonably large, which may be perceived as unacceptable since a few must bear the heavy fines for a crime committed by many. In theory, few would evade taxes with such fines. On the other hand, in the eyes of the public, penalties should fit the crime (Sandmo, 2004).

3.2.2 Individuals in the scope of their employment

To improve our understanding of crime prevention, we need to understand employees' motivation to commit crimes in their workplace. Arlen (2011:156) defines corporate crime as "*… crimes committed by employees in the scope of their employment with some intent to benefit the firm*". For instance, if the CFO underreports the earnings of the firm to reduce the tax payout, it is considered a corporate crime because the CFO acts in the scope of his employment. A key difference between individual and corporate crime is that an individual who evades personal tax will directly benefit, i.e. they have more money at hand. However, if an individual evades taxes on behalf of the firm, it is the firm that directly benefits. The individual can only benefit indirectly. Section 2.3 discussed a manager's compensation policy as an indirect method to benefit.

Conveniently, corporations can influence the cost and benefit of corporate crimes. Firstly, firms can induce wrongdoing because they directly control the policies that determine to what extent employees benefit from a crime, e.g. compensation, promotion and retention policies. Secondly, firms can act as enforcers by implementing *ex ante* preventive measures, e.g. change the compensation policy, to discourage criminal behaviour. Thirdly, the firm is well situated to investigate violations *ex post* with easy access to corporate documents etc.

The firm could become a potential victim of their own misbehaviour where perceived short-run benefits cause excessive damage in the long-run (Arlen, 2011).

Furthermore, two types of corporate crimes are as follows. On the one hand, in closely-held owner-manager controlled companies, crimes typically relate to the benefit of the firm. That is, the controlling agent genuinely acts on behalf on the firm and will not see any personal gain unless the firm benefits. Similarly, he will also suffer the full potential costs. So, the shareholders gain from the firm's prosperity. The extent of the gain depends on the violator's equity share in the company, α, and the benefit is αb. According to Arlen (2011), the authorities ought to impose individual liability to withhold any gain to wrongdoers.

On the other hand, when ownership and control is separate, e.g. a publicly-held company, non-owners who control the company have a tendency to be motivated by personal benefit at the expense of the firm (Arlen, 2011). Now, individuals benefit indirectly as previously mentioned. Arlen (2011) focuses on corporations where crimes are committed by non-owners/managers.

3.2.3 The Extended Model

In a non-perfect world, there exists an asset inefficiency because individuals do not have unrestricted wealth, and hence, can not afford the imposed fine f*. Arlen (2011) explains that f* is infeasible because corporate crimes harm society to a larger extent than individual crime since the corporation extends the individual's reach to affect more people. And, corporate crime is problematic to detect and prove because so many different agents are directly or indirectly involved in the act (Arlen & Kraakman, 1997; Buell, 2006). Particularly *mens rea* is difficult to ascertain in the absence of an investigation. In other words, the probability of sanction without enforcement is miniscule, and corporate crime is no longer feasibly deterred through individual liability and monetary sanctions (Arlen, 2011).

Therefore, the state must devote resources to enforcement. A typical enforcement instrument is the threat of imprisonment, which can be preventive. However, individuals can not physically survive sufficiently long sanctions due to age and health restrictions. Besides, with very strict sanctions for non-violent offences, then the sanction enhancement for violent

offenses is weakened (Sandmo, 2004; Arlen, 2011). As well, the total cost of imprisonment in corporate crime cases can be colossal.[48]

In her extended model, Arlen (2011) introduces the idea of corporate prevention and policing as the two most cost-efficient solutions to deter corporate crime. She reasons that the firm is perfectly positioned to deter crime since it influences the expected benefit and cost of the crime, the probability of detection and sanction, and the size of the fine (Kraakman, 1986; Arlen, 1994; Arlen & Kraakman, 1997; Arlen, 2011). In order to incentivise corporations to exort their influence over these variables, Arlen (2011) argues that the state should apply strict corporate liability to encourage corporations to adopt preventive measures.

For example, Arlen (2011) suggests to connect individual's compensation to the long-term performance of the firm. Thereby, an individual is less inclined to act illegally for a better short-run performance and leave before the firm suffers the long-term damage. By restructuring compensation policies, firms can reduce the individual benefit of a crime, which will prove more cost-efficient than an *ex post* investigation and sanctioning.

For instance, Wells Fargo, an American company that offers financial services, induced employee misconduct because of their compensation and promotion policy, and arguably, pressure from the top. The threat of termination was expected unless employees met the very high targets of new account customers. As a result, employees began signing new accounts without customer approval. Similar examples exist where employees' bonuses depend on the delivery of goods overseas, which can induce bribery of foreign officials to clear the goods through costums (Arlen, 2017). As such, preventive measures could deter corporate crime. Hollingsworth's (2002) study illustrates a similar case in relation to tax evasion.

In contrast, whereas preventive measures reduce the value of the crime, corporate policing increases the probability of detection and sanctioning. To do so, the firm performs *ex ante* monitoring, *ex post* investigation and collaboration with the authority to detect crime and identify and sanction the responsible individuals. With corporative collaboration, the cost of enforcement is lower because the firm offers the most cost-efficient policing measures. For example, during day-to-day operations, the firm collects information and is better suited to analyse the information and identify irregular activity, than the state. Additionally, the firm

[48] The total cost of imprisonment is not limited to incarceration, but also e.g. the cost of removing a productive individual from society (Arlen, 2011).

obtains evidence at a lower cost than the state by freely accessing their own information (Arlen, 2011).

For firms to adopt these measures, the cost of implementation can not exceed the social benefit.[49] In addition, the state must enforce greater sanctions to firms that do not police optimally compared to those who do. Thus, firms are better off to adopt optimal police measures, even if policing measures implies a greater probability that crimes are detected. For crimes not deterred, it is important to have individual liability to hold the responsible accountable. However, corporate liability remains necessary to account for the individual asset inefficiency (Arlen & Kraakman, 1997; Arlen, 2011).

Although prevention is induced by the use of *respondeat superior* liability, it fails to induce optimal policing because the corporate benefit of policing is less than the social benefits. It is less since the probability of being sanctioned increases for the crimes they fail to deter, and thus increase the expected liability for the crimes (the *liability enhancement effect*) (Arlen, 1994; Arlen & Kraakman, 1997; Arlen, 2011). Strict corporate liability could actually abstain the firm from policing if the *liability enhancement effect* exceeds the *deterrence effect* because then the cost would outweigh the benefits of policing (Arlen, 2011). Essentially, firms are discouraged to optimally police because it will inevitably increase their liability if the firm is held strictly liable for the misconduct of its employees or managers (Arlen, 2017). Accordingly, strict corporate liability with a given fine ($f = H/P^*$) is similar to a double-edged sword, in the sense that it deters some crimes but guarantees sanctions from the crimes it fails to deter, and restricts firms from optimally investing in *ex ante* monitoring and *ex post* policing (Arlen, 1994; Arlen & Kraakman, 1997; Arlen, 2011). Naturally, the concept receives criticism for sanctioning firms that actively engage in optimal policing.

Arlen (2017) illustrates how strict corporate liability discourages optimal policing. Assume a firm detects misconduct and faces the dilemma of whether or not to self-report to the authorities and fully cooperate. On one hand, the firm can report and provide ample evidence of the crime to ensure the responsible individual is held liable. Thus, future crime has been deterred as the state punishes the responsible individual(s) and signals to potential violators that crime does not pay off. However, the firm expects to be held liable for its employee's misconduct. Assume self-reporting and collaboration result in a $100 million fine imposed

[49] The social benefit is measured by the deterred harms due to corporate policing (Arlen, 2011). Firms feel social harm, H, through market powers and receive benefit H by deterring the crimes. Arlen (2011) refers to this as the *deterrence effect*.

by the government. The probability of detection and sanctioning in the case of self-reporting is guaranteed and equals one (P = 1).

On the other hand, authorities are unlikely to detect and sanction corporate crime on their own due to the complexity and covert nature of corporate cases. In other words, corporate liability is not guaranteed in the absence of self-reporting. In fact, P is probably fairly low. In the unlikely case of being detected, the government would still have difficulties finding sufficient evidence to prosecute without the collaboration of the firm. As a result, the expected liability without self-reporting is P($100 million), which is much lower than $100 million. Thus, it is easy to argue against optimal policing from the firm's perspective (Arlen, 2017).

Additionally, firms become unable to deter misconduct with the threat of self-reporting the crime. Once employees are aware that self-reporting is an irrational choice, the credibility of the threat falters and firms loose another tool to deter criminal activity within the firm. We can not expect firms or individuals to act a certain way unless it benefit them. Thus, the authorities must structure corporate liability so firms are worse off when they do not self-report than when they do (Arlen, 2017).

3.2.4 Multi-tiered duty-based libility regime

Arlen (2011) suggests the use of duty-based sanctions to optimally deter corporate crimes. Specifically, there are three key duties firms are subject to, i) *ex ante* monitoring, ii) self-reporting the crime, and iii) *ex post* full collaboration with the authorities. Firms that fulfil all duties are granted significant mitigation, and possibly exemption from corporate liability. By imposing fines on firms that fail to fulfil these duties, firms that do comply will be "rewarded" by receiving no penalty (Søreide, 2016).

Firms make decisions sequentially, i.e. they monitor then self-report and collaborate. Accordingly, Arlen (2011) advocates the use of a multi-tiered duty-based regime where firms are better off responding optimally at each stage of the policing process, even though they failed to respond optimally at the previous stage. Figure 3 shows a simple illustration of the multi-tiered system. She argues that a multi-tiered regime is more effective than a single duty-based sanction due to agency costs within publicly-held firms that potentially cause firms not to act optimal in a specific stage, which could result in a change in management. For example, a manager could act in his best interest although it causes harm to the firm and the shareholders, who in the subsequent stage hire a new manager. Thus, the firm ought to be

incentivised to act optimally in the following stage under new management. In essence, if a firm detects a violation, they face an additional sanction only if they fail to self-report it, then an additional worse sanction if they refuse full cooperation. If correctly structured, the sanctions induce optimal policing. Nonetheless, the sanction has to be sufficiently high to ensure firms that do self-report are better off than those who do not. In addition, the fine imposed on firms that fail to satisfy the optimal policing requirements should be a criminal sanction.

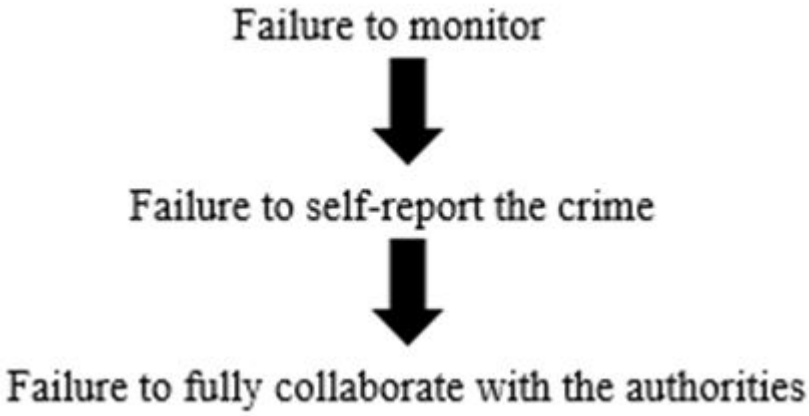

Figure 3: An illustration of Arlen's multi-tiered duty-based system. The bottom tier where the corporation has failed all its duties, brings the most severe sanction.

By contrast, firms that do satisfy the duties should face a civil residiual monetary sanction, S, to also induce optimal prevention.[50] For non-compliant firms, the civil sanction is imposed in addition to the criminal penalty (S + F). Arlen (2011) proposes that the size of the sanction should equal the total social cost of the crime that the firm would otherwise suffer through market forces so $S^* = H / P(M^*, R^*)$, where the probability of sanction if the firm takes part in optimal *ex ante* and *ex post* policing is $P(M^*, R^*)$.[51]

[50] Note that the use of residual liability could also prevent cases of window-dressing where there exists asymmetrical information between law enforcement and corporate management. Window-dressing implies that corporations appear to have a well-functioning compliance system and a zero tolerance for corrupt activities, yet act illegally behind the curtain. In reality, window-dressing is a common weakness of duty-based sanctions that residual liability could mitigate (Søreide, 2016).

[51] Arlen (2011) suggests the total sanction (S + F) imposed on firms that do not comply with the duties has to be at least five times greater than the sanction imposed on compliant firms, assuming a 20 percent probability of sanctioning without collaboration from the firm. Based on the previous literature, that probability is likely to much lower, which implies the fine will be more than five times greater for non-compliant firms.

Furthermore, Arlen (2017) advocates the use of PDAs to improve criminal liability, and most efficiently implement her multi-tiered based regime.[52] PDAs are popular among wrongdoers as they avoid prosecution and severe reputational damages. Negotiated settlements are also beneficial to the government. Trials are time-consuming and expensive for both parties, hence, a speedier resolution will benefit all. In addition, it allows prosecutors to pursue more cases, which increases deterrence (Arlen, 2017). However, if the prosecutor is given too much discretion, the outcome of the negotiation becomes unpredictable, which reduces a firm's incentive to enter a negotiation in the first place (Søreide, 2016). A method to improve the predictability of negotiated settlements is increased transparency of the negotiation and verdict. However, high transparency and public access to the settlements could cause reputational damage for the company, which in itself, is a preventive mechanism.

The EC uses settlements as an efficiency measure to conclude cases faster. The cartel participant receives a non-negotiable 10 percent fine discount in exchange for admission of guilt. The settlement speeds up the procedure once the firm understands the strength of the EC's case (European Commission, 2019b). Initially, the discount was considered too low to induce change. However, firms found it beneficial to open a dialogue with the EC and discuss the case, even if the EC stresses that there is no plea-bargaining available in the EU (Anderson & Cuff, 2011).

Similarly, it is possible to reduce the sanctions imposed by confessing to the crime in Norway. Upon confession, offenders commonly receive a more lenient sentence as long as the evidence supports the confession (Søreide, 2015). The Ordinary Civil Penal Code (Criminal Code) § 59 states that if the violator voluntary confesses *before* he becomes aware of any investigation, the court can offer a discount.[53] However, the defendant runs the risk of confessing too much, which could discourage a confession. Still, the evidence must support the confession, which implies that an investigation still has to take place.[54] Alternatively, if a

[52] PDAs are negotiated settlements that enable a continous discussion about the extent of self-reporting, required cooperation and the firm's benefit between the firm and enforcement authorities (Arlen, 2011). Søreide (2016) supports that there must be some form of dialogue between representatives from the criminal justice system and the alleged wrongdoer to complete an assessment of compliance systems and corporate performance.

[53] See https://lovdata.no/dokument/NLO/lov/1902-05-22-10/KAPITTEL_1-7#%C2%A759 (Norwegian) for more information about the Ordinary Civil Penal Code ("Almindelig borgelig Straffelov (Straffeloven)").

[54] Similarly, Konkurransetilsynet (n.d.) states that in order to qualify for a full amnesty, the firm must present all the evidence it has knowledge of, and fully cooperate with the authorities. However, the only party that is aware of the extent of

company confesses to one thing, the authority can promise not to investigate another area of the business. However, if this practice is exercised, companies can confess to lesser crimes to avoid investigation of more severe cases.

3.2.5 Implications for tax evasion

Arlen (2011) advocates *ex ante* and *ex post* interventions to reduce the expected value of corporate crime. Her theory relates to general corporate crimes, and should therefore also apply to tax crime.

Companies should implement preventive measures to discourage criminal behaviour. Previously, in Section 2.3, a compensation policy was discussed where Crocker and Slemrod (2004) proposed that the compensation policy of the CFO should inversely depend on the effective tax rate. In addition, the study by Hollingsworth (2002) showed that policies can be structured to encourage misconduct. According to Arlen (2011), the state should impose vicarious liability to induce firms to implement preventive measures.

In addition, companies should optimally police the organisation by investing in *ex ante* monitoring, *ex post* self-reporting and *ex post* investigation, and inform their employees of their intention to do so, to signal a strong probability of detection, which has a deterrence effect. By doing so, companies are likely to deter tax crime, and show the authorities that they have done everything in their power to deter crime. Naturally, firms that fulfil the duties deserve to be "reward" by receiving a lower penalty than those who do not, as a compensation for the cost of implementation. However, I have found no evidence that this is the case in Norway. Therefore, as the situation stands, a firm seems unlikely to optimally police in accordance with Arlen's theory due to absent incentives to do so.

collaboration and evidence presented, is the firm itself. Without an investigation, the authorities can not confirm their compliance.

3.3 Spagnolo (2000; 2003; 2005), Divide et Impera: Optimal Leniency Programs.

In his final version of *Divide et Impera*: Optimal Leniency Programs (2005), Giancarlo Spagnolo investigates how leniency programs deter cartels. He emphasises that firms are rational entities that defect and self-report if the payoff from doing so exceeds the payoff from sustaining the collusive agreement. He introduces the idea of a leniency program that rewards the first reporting agent a sum equal to the fines paid by all the other parties, and refers to this as a "courageous leniency program". With sufficiently high rewards, the program achieves the first-best outcome with maximum deterrence with no enforcement expenditure. If political and institutional characteristics restrict the use of rewards, Spagnolo recommends moderate leniency programs, which either reduce or cancel sanctions, as useful tools.[55] An full amnesty is an example of cancelled sanctions. However, a moderate program requires enforcement costs, and hence, only achieves the second-best case.

3.3.1 Optimal leniency programs

The discounted value of expected payoffs from sustaining a collusive contract is V^c. Individually defecting from fthe cartel yields payoff V^d, including any disciplinary punishment imposed by the cartel for defecting. A rational firm will not defect if $V^c > V^d$, so the cartel endures.

In the absence of leniency programs, where the reduced fines (RF) equal the monetary fine (F), Spagnolo (2005) argues that the state's optimal law enforcement is to publicly announce that defectors will not be pursued or sanctioned for previous violations. That is, the probability γ that a defector will be convicted after defection is optimally set equal to zero.[56] If defection from a cartel pardons previous transgrassions, firms are more prone to do so, which undermines cartel activity (Spagnolo, 2005).

[55] Konkurransetilsynet offers no monetary rewards for the first reporting agent. The optimal leniency a firm can receive is a full amnesty, which is only available to the first reporting agent (Konkurransetilsynet, n.d.).

[56] Spagnolo (2005) proposes that a unilateral defection could reveal the existence of a cartel and thereby increase γ. If the AA does not differentiate their treatment of defectors and non-defectors, firms could be encouraged to remain in the cartel. Thus, it is important that the state publicly announce their intentions of not pursuing defectors ($\gamma = 0$). When leniency programs are available, Spagnolo assumes $\gamma < \alpha$, the latter being the probability that a firm will be convicted while colluding. A greater probability of being prosecuted while in a cartel encourages defection.

According to Spagnolo (2005), offering satisfactorily generous leniency programs can have an *exploitable* and an *effective* effect, which he uses to characterise the optimal leniency program. Firstly, too generous programs can increase V^c. For example, in each period, firms enter a collusive agreement, then collectively report the cartel to avoid detection and sanctions. This strategy, $V^{c'}$, reduces deterrence. The program is exploitable if $V^{c'} > V^c$. Leniency programs can not decrease the value of collusive agreements because firms can always choose not to report. Thus, the value of the collusion will be max $\{V^c, V^{c'}\}$ (Spagnolo, 2005).

To mitigate the exploitability, the AA must restrict the leniency program to the first agent that self-reports, the so called first-come rule. Otherwise, fewer agents pay the full fine each period. Still, it is possible to split the total fine among all participants, including the one who receives the lenient treatment. Alternatively, firms take turns to self-report (Spagnolo, 2005; Aubert et al., 2004). However, strict repeat penalties and pattern recognition should prevent this.

On the other hand, sufficiently generous leniency programs and the first-come rule incentivise firms to independently defect and report. This strategy, $V^{d'}$, increases deterrence. Similarly, this strategy does not reduce the value of defecting since the agent can always choose not to report if $V^{d'} < V^d$. Therefore, the value of defecting is max $\{V^d, V^{d'}\}$. However, the aim of the leniency program is to encourage self-reporting by offering a higher payoff, which it does not if $V^{d'} < V^d$. In this case, defecting and not reporting would be best, which makes the program ineffective. A program is only effective if a defecting agent can increase their payoff by reporting to the authorities, $V^{d'} > V^d$ (Spagnolo, 2005).

Spagnolo (2005) proposes that "*independent of how many firms are eligible, the leniency program is effective if* $RF < \gamma F$". A defecting firm receives a reduced fine lower than the expected fine when defecting γF, and as such, the value of defecting increases by also reporting. Here, eligibility is irrelevant and it is only the size of the reduced fine/reward that matters. Spagnolo (2005) calls this the *protection from fines* effect since the leniency program protects the defector from γF.

Furthermore, an optimal leniency program must be subject to the first-come rule for a couple of reasons. Firstly, to weaken the exploitability and collect more fines. The fines should be maximised to increase the expected cost of cartel activity and increase the total reward offered to the first reporting agent. A larger reward further encourages a rational agent to cheat on the partners and disrupt a collusiv agreement. Spagnolo (2005) refers to this as a

"couragous leniency program", which yields the first-best scenario with complete and costless deterrence.

According to Spagnolo (2005), enforcement actions and the optimal reward, RF* = $\underline{RF}$ = -(N–1)F, become substitute enforcement tools.[57] The probability that cartel participants are detected and sanctioned in a period where all members obey the collusive agreement is given by α. A high α implies that cartel members are likely caught and sanctioned, hence, rewards must be small, and vice versa. Otherwise, moderate rewards become attractive and exploitable (Spagnolo, 2005). Because rewards are self-financed, authorities should minimise enforcement costs and wait until someone self-reports.[58]

Secondly, if leniency is restricted to the first reporting agent, and the optimal fine is imposed on the second, third etc. agent, then tension and mistrust arise between the cartel participants. In fact, the "winner takes all" approach establishes a race to report between the members fueled by the fear of arriving second. For example, imagine that a cartel believes that law enforcement is onto them, and each member is aware that either partner can report to save themselves and seal the fate of the rest. The emerging fear encourages a race to report (Hammond, 2000; 2001). In the absence of the first-come rule, firms could simply prepare themselves to report in case someone else did, then sit back and wait (Spagnolo, 2005).

3.3.2 Moderate leniency programs

However, Spagnolo (2005) acknowledges that political and institutional restrictions can limit the size of fines imposed and rewards offered. Therefore, he introduces a moderate leniency program bound to be non-negative, i.e. rewards are removed, and sanctions can only be reduced or cancelled. Since first-best is no longer feasible, Spagnolo (2005) suggests moderate leniency programs require supplement investigation and enforcement actions, which implies that α and investigation costs are positive.

According to Spagnolo (2005), moderate leniency programs with the first-come rule are still helpful. First, the *protection from fine* effect still applies. As long as the moderate leniency

[57] The optimal reward (a negative reduced fine) is a positive monetary compensation that equals the number of cartel members, minus the defector, multiplied with the maximum fine

[58] Spagnolo (2005) defines a self-financing leniency program as $\sum$ Reduced Fine $\leq \sum$ Fine, where RF < 0 implies a reward to the reporting agent and RF > 0 is simply a reduced fine, and F is the monetary fine imposed on a colluding party. Thus, the sum of the reward offered to the reporting agent is less or equal the combined sum of fines imposed on the other parties (Spagnolo, 2005).

program yields a greater expected payoff, in the form of a lower expected fine, compared to defecting and not reporting, it will be rational to report (Spagnolo, 2005).[59] The second effect relates to the DOJ statement's about the importance of the first-come rule. That is, even moderate leniency programs increase the perceived riskiness of illegal contracts. When only the first reporting agent is granted leniency, firms fear arriving second. As a result, the trust between the collusive agents erode. According to Spagnolo (2005), this *strategic risk* is the most important variable that increase deterrence, and is ignored by Motta and Polo (2003).

3.3.3 Aspects absent in the model

Naturally, not all empirical aspects can be incorporated into his model and he concludes the paper with absent features. Firstly, the aspect of restitution was not included in Spagnolo's model. However, according to the U.S. Corporate Liability Program, it is a requirement that collusive firms repay the cartel induced profits to customers.[60] This additional expense reduces the appeal of self-reporting. Thus, firms demand greater fine reductions or rewards to compensate for this extra loss. Spagnolo (2005) argues that the concept of restitution is clearly counterproductive and should be removed.

Secondly, Spagnolo (2005) focuses on the firm, and does not discuss the relevance of individual liability and rewards, and the following agency costs. He suggests it will have an instensifying effect on incentives to self-report, and the paper that does account for this effect is discussed in the next section.

Thirdly, members of a cartel could be disciplined through a fit-the-crime scheme which discourages employees to blow the whistle because they fear retaliation. For example, in the

[59] With moderate leniency programs, $\gamma > 0$, which implies positive investigation costs and an approach to apprehend and prosecute defectors for their previous transgressions.

[60] Although it is no requirement, Konkurransetilsynet (n.d.) states that cartel participants run the risk of suffering compensation issues with the customers as an additional cost of detection.

U.S., the *Qui Tam* provision[61] revealed that whistleblowers were often subject to harsh retalitation from the firm.[62]

3.3.4 Implications for tax evasion

Spagnolo emphasises efficient deterrence tools. He argues that rewards and enforcement actions become substitutes and that the former should be favoured since it requires less resources. Assuming sufficiently large rewards are feasible, a rational agent self-reports to cash in. So, what does Spagnolo's theory propose Skatteetaten ought to do?

To begin, consider the first-best relative to tax crime. Can Skatteetaten achieve complete and costless deterrence based on this literature? Doubtful. Spagnolo's self-financed reward system requires multiple parties where one is rewarded and the others penalised. However, with tax crime occuring internally, there are no other external parties that can finance a reward. This also complicates the "winner takes all" effect and race to report.

The alternative is to look at the other parties within the firm. If individuals are given a sufficient incentive to self-report, they do so. As long as the first-come rule applies, this would cause a similar race to the authorities and secure a "winner takes all" solution. Assume there are 3 individuals responsible for the corporate tax evasion, that an audit would reveal all of them and that individuals are held liable for the crime. Then each person would have an incentive to self-report in exchange for leniency. If the first reporting agent receives a reward equal to the total fine, F, imposed on the two others, there would be a "winner takes all" and race to report effect. Individual liability is then crucial for a similar effect.

However, there are several flaws with this example. First of all, individual liability is typically poorly enforced. Proving *mens rea* is time consuming and exhausts resources. It is generally easier to hold the corporation liable whereas the responsible individuals get away. Besides, if maximum fines are imposed, there is likely to be an asset inefficiency a la Arlen (2011), and (feasible) fines imposed on individuals may not create a basis for an adequate

[61] The *Qui Tam* stems from a phrase that translates to "he who brings an action on behalf of the King, as well as for himself". If companies or individuals defraud the government, the provisions allow whistleblowers to file lawsuits against them to recover damages on the government's behalf under the U.S. False Claims Act (FCA). A certain percentage of the recovered funds are given to the whistleblower (Spagnolo, 2006).

[62] For more information about retaliation against whistleblowers, see Gambetta and Reuter (1995) who research the Sicily Mafia in legitimate industries.

reward pot. In addition, a courageous program could be exploitable if an individual evades tax, and applies for a leniency program.

If there is no reward to claim, individuals will not rush to report. However, if an audit occurs, then a moderate leniency program could create a similar rush between the agents, and save the state an extensive investigation. This would require a law reform since it would not be considered “voluntary” to self-report. A more satisfying solution would be to offer an informed employee a monetary reward to induce spontaneous self-reporting. That is, offer rewards to whistleblowers, which is considered in the next section.

3.4 Aubert et al. (2004), The Impact of Leniency Programs on Cartels.

Cécile Aubert, Patrick Rey and William Kovacic fashioned an independent paper that compliment Spagnolo's (2005). Aubert et al. (2004) support Spagnolo's (2005) findings that rewards have a greater deterrence effect than reduced fines, and present an alternative deterrence tool: whistleblowing. Their findings suggest that individual rewards provide a stronger incentive to self-report and have a greater deterrence effect than corporate rewards.[63] In addition, bounties create agency costs between the principal and agent. In order to silence informed employees, the employer buys their fidelity. This compensation to employees reduces the value of the collusive agreement, and makes it less attractive.

Furthermore, whereas most legislations do not allow leniency to the cartel leader, Aubert et al. (2004) propose that even the leader should be eligible for leniency programs. Then, potential participants are hesitant to join as the leader could initiate a cartel with the intention to report and receive leniency afterwards. This could prevent the development of a cartel.[64]

3.4.1 Reward individuals for information

Aubert et al. (2004) propose an individual bounty mechanism complementary to corporate liability where the AA offers bounty b to employees of colluding firms in exchange for incriminating evidence. If the AA's resources do not allow for bounties, a self-financing system is more plausible where the bounty equals a percentage of the fines collected, similar to the *Qui Tam* provision.

Furthermore, high executives liable for prosecution should especially be offered full leniency as this creates a strong incentive to come forward. In the U.S., individuals can be held criminally liable and face imprisonment. Protecting top management from imprisonment illustrates how much more powerful leniency programs that target individuals instead of corporations can be.

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[63] They differentiate between reward and bounty, which refer to corporate and individual compensation, respectively. Unless otherwise specified, this terminology applies.

[64] Konkurransetilsynet (n.d.) does not refer to the ring leader, but firms that coerce others to participate are not eligible for the amnesty.

The logic behind their theory is straightforward.[65] If the AA offers bounties to whistleblowers, the employees require compensation from the employer to keep quiet. The compensation costs drastically reduce the value of the collusive agreement. The size of the compensation must be at least as large as the bounty offered by the AA (Aubert et al., 2004). In addition, the more informed employees of the crime, n, the more bonuses the firm has to pay, which reduce collusive profits, π^M, by nb. The overall collusive profit in each period equals $\pi^M - \rho F - nb$, where ρ is the probability of an industry audit that is likely to uncover hard evidence of collusive activity, and ρF is therefore the risk of a fine.[66] The impact of the reward system is multiplied because as n increases, collusion becomes less profitable because the firm has to pay each informed employee even though only the first employee to report receives the bounty.

With a long-lived employment, Aubert et al. (2004) conclude that in the absence of corporate leniency, bounties fail to influence the sustainability of collusion. The firm would have to pay a constant fidelity fee of $B = (1-\delta)b$, where δ is the discount rate, even after defection from the cartel, hence, the firm would not defect. The reasoning is that the employees are assumed to hold hard evidence of previous misconduct, so the firm must continue to compensate them even after it has defected from the cartel. In contrast, with corporate leniency, bounties can abolish collusive agreements because defecting firms have an incentive to apply for leniency and report the cartel. In this case, the defector avoids the sanction and the lifetime compensation expenditure to informed employees.

Furthermore, if employment exceeds one period, the bounty must account for the discounted future income a whistleblower sacrifices by reporting to the AA. The magnitude of the bounty is difficult to determine, but it has to be significantly generous to induce whistleblowing since it is likely that the whistleblower's career with the firm, and possibly the industry, is over. Thus, the expected future earnings of the employee from the firm must be accounted for (Aubert et al., 2004).

In addition, the potential weaknesses of bounties can actually increase deterrence. For example, the employment structure becomes more stringent and less effective if firms retain

[65] Note that Aubert et al. (2004) assume a short-lived period of one period. The assumption is ambigious and they do not offer any insight into the length of a period. If the employment is short, e.g. 1 year, the likelihood of finding evidence or partake in the scheme is small.

[66] The parameter ρ is subject to the enforcement actions by the authorities in the absence of reports. Without self-reporting, ρ remains fixed over time.

informed and ineffective employees that otherwise would denounce the firm upon termination. In addition, collusive firms may act competitive on the surface to avoid employees' suspicion. Both points make collusion less attractive and increase deterrence by reducing efficiency and the direct cost of fooling their employees, respectively.

3.4.2 Implications for tax evasion

The theoretical approach of Aubert et al. (2004) advises law enforcement to implement effective whistleblowing channels and introduce bounties to individuals, which could have optimistic implications for tax crime. Firstly, Aubert et al. (2004) show that sufficiently large rewards can destabilise cartels. We can assume that employees prioritise and seek to maximise their own payoff. So, they will whistleblow if it makes economic sense. Similarly, informed employees of tax evasion would whistleblow if given a sufficiently large bounty in exchange. However, Aubert et al. (2004) discuss the implementation issues, specifically, how the reward is financed. They suggest a self-financing system a la Spagnolo (2005) where the reward is a percentage of the fines collected. One such system is the aforementioned *Qui Tam* mechanism. However, the FCA does not include tax fraud.[67] Instead, the IRS Whistleblower Office introduced a reward system for tax whistleblowers in 2006, which is discussed in detail in Section 5.2.1.[68]

Furthermore, in Section 2.3, I assumed that minimum two individuals are involved in the scheme, but that the number of informed employees is likely to be much greater. So, if each informed employee has the option of blowing the whistle on their employer to receive a bounty, why would they not? Aubert et al. (2004) write that in order to secure the fidelity of their employees, the employer offers them a compensation, which deters tax evasion as the value of the scheme decline. Thus, the existence of whistleblowing programs alone could have a deterrence effect if employers foresee this scenario.

Moreover, if the corporation quits the evasion behaviour and restores the financial statements, employees could possess hard evidence of wrongdoing. Similarly to the cartel detection, the firm would have to continue to compensate the employee if there are no

[67] Carson's et al. (2008) findings for the 1997 to 2001 period suggest the benefits of *Qui Tam* exceeds the costs by a ratio between 14:1 to 52:1. That is, for every dollar spent on the program, they earned between $14 and $52.

[68] The U.S. Securities and Exchange Commission (SEC) also has a whistleblower program. For more information, see their 2018 annual report https://www.sec.gov/files/sec-2018-annual-report-whistleblower-program.pdf.

corporate leniency programs. On the other hand, if the firm can apply for an amnesty, it could desist the compensation payouts. Aubert et al. stress this point so firms will defect and report, instead of simply defecting, to take down the remaining cartel participants. However, with tax crime under my assumptions, there are no other external parties to report. Instead, reporting could hold the responsible individuals accountable, but they are likely to be part of both the management and the decision to apply for an amnesty. Thus, I believe it would be difficult to capture the same effect with tax crime. That being said, the concept of targeting individuals within the firm by offering a bounty seems sensible to implement. Individuals have a strong incentive to self-report corporate tax crime, the government save resources and employers know their employees can whistleblow, which has a preventive effect.

4. Methodology

The following part describes the research process, with the intention that future researchers can accurately compare the findings. Section 4.1 explains the research design. Section 4.2 shows the collected data, namely a literature and two interviews. Finally, Section 4.3 discusses the limitations and quality of the research.

4.1 Research design

The thesis has an exploratory research design in the sense that it seeks new insights about a topic and discovers "*what is happening"* (Robson, 2002). Because of the secretive nature of corporate crime, and that violators have a strong incentive to keep their actions hidden, quantitative data on the extent of corporate tax evasion is difficult, if not impossible, to collect. Therefore, I conducted a thorough literature review and held two interviews to collect non-numerical data.

The literature has been necessary to prepare for the interviews with Skatteetaten and Økokrim. As such, the thesis has a deductive approach where I have shaped the questions in the interviews based on the collected data from the literature review. I began with the literature to gain insight into the leniency program literature and it allowed me to narrow my focus towards specific topics that were more relevant to tax evasion.

4.2 Collected data

4.2.1 Literature

The objective of a literature review is to gain an understanding of what we do and do not know. The literature review aims to provide a deep understanding of economic incentives to self-report from the cartel literature. With limited literature that directly relates self-reporting and corporate tax evasion, the cartel literature has proven itself valuable, and I have identified features that incentivises corporations to self-report.

Evidently, the literature highlights the U.S. judicial system and institutions, which differ from the Norwegian system. I expect this to have an effect on the findings. The selection of

the chosen theories relies on my own judgement, and Google Scholar and other papers' reference list are the primary tools used to find sources.

4.2.2 Interview

The primary data was collected with two non-standardised interviews with Skatteetaten and Økokrim in Bergen and Oslo, respectively.[69] The purpose of the interviews was to assess empirical law enforcement in Norway, i.e. what is done against corporate tax evasion. Therefore, I required "*information rich*" (Krueger & Casey, 2005:25) interviewees with a credible and in-depth knowledge of the topic.

Therefore, I interviewed one anonymous representative from Skatteetaten ("the Subject") and two representatives from Økokrim, all of which have extensive experience of tax crime and the use of tax amnesties. First, I met the Økokrim representatives who offered valuable background information about the investigation process and the roles of Skatteetaten and Økokrim, including a discussion on civil and criminal liability. Unfortunately, they were unable to answer the majority of questions on behalf of Økokrim, and advised me to interview Skatteetaten to clarify further.

The Subject provided ample knowledge and we later corresponded over email to discuss more. The interview questions and summary is attached in Appendix 8.2. His input has significantly strengthened the thesis. In addition to the Subject, a contact person in Skatteetaten also put me in contact with two representatives from the legal department in Skattedirektoratet. Because of time constraints, a face-to-face interview was difficult. Instead, they clarified some questions over mail.

Sampling method

The small sample size is caused by the limited number of appropriate and available interviewees. The selection of the interviewees is based on my own judgement to select a purposive sample that best matched the research question (Saunders et al., 2009). All the interviewees come from departments that deal with tax crime in law enforcement, this common feature satisfies a homogeneous sample, a common purposive sampling technique

[69] There are two types of non-standardised interviews, both of which are fairly informal compared to structured interviews (think questionnaires). Semi-structured interviews typically involve a predetermined list of questions, whereas unstructured, or in-depth, interviews are informal talks that explore a subject in depth (Saunders et al., 2009). My interviews were a combination of the two.

that is suitable for an in-depth study (Saunders et al., 2009). However, this could imply they share a similar bias against tax evasion, which is difficult to account for. A larger sample size would certainly be beneficial to the thesis, but was unattainable due to time and resource restrictions. For example, interviewing corporations to understand their standpoint would have been very useful.

4.3 Methodology weaknesses

As previously mentioned, the selection of literature and subsequent theory has relied on my own judgement, and there is a chance my choices have been inappropriate and that more suitable theories have been omitted. Similarly, this thesis reflects my understanding of the theories, which could be incorrect. With no law backgrond, this effect could be particularly prominent in terms of legal terms. I have also made certain assumptions that may not hold.

In addition, although I had a contact person in both organisations, finding the most appropriate interviewees was difficult, particularly in Skatteetaten. Even though all the interviewees have experience with tax crime and tax amnesties, it was evident that their area of expertise did not directly relate to this thesis' topic. Therefore, I did not necessarily interview the most suitable individuals, which could negatively influence the findings. A possible implication is that valuable knowledge has been left out or that the importance of some topics have been either under- or overstated during the interviews.

Furthermore, each interview provided ample information that lead me towards an abundance of literature that provided more questions than answers. As such, additional interviews would have allowed me to continuously build on my knowledge and narrow down the topic at hand. For example, the questions asked during the interviews seemed to be of upmost importance at the time, but in retrospection, now that I have acquired more knowledge, I would have asked slightly different questions. The implications of this could be that some important topics have been omitted from the thesis. This has also severely restricted my analysis as the focus of the thesis has fluctuated across the semester. Nonetheless, similarly to an explorer, the findings in an exploratory study represent reality at the time of discovery, something that will have implications for the quality of the results as we will see next.

4.3.1 Quality of the research

All researchers have concerns about the quality of their research and findings. Raimond (1993:55) expresses this as the "*how do I know?*" test. Will the research and findings hold up against close inspection? According to Saunders et al. (2009; 2016), we can not know with absolute certainty if the results hold. The only option is to reduce the likelihood of being wrong. Researchers often rely on reliability and validity to assess the quality of the study. However, this approach is based on a positivist[70] approach, which is inappropriate for qualitative and exploratory studies (Saunders et al., 2016).[71]

Alternatively, the interpretivism philosophy proposes that different people, at different time and place yield different meanings. As such, it questions the positivist view that there exists universal laws that apply to everyone. Instead, the interpretation of data is subject to time and place (Saunders et al., 2016). Interpretive assumptions, where reality is multifaceted, are better suited to assess the quality of qualitative work.

Reliability

Under positivist assumption, consistent findings prove a strong reliability (Saunders et al., 2009). However, with qualitative data and the lack of standardisation, concerns about reliability are expected. Marshall and Rossman (1999) and Saunders et al. (2009; 2016) argue that findings from non-standardised research methods are not meant to be replicable because these findings represent reality at the time of collection. As the situation is subject to change, so will the findings be. In fact, the strength of non-standardised interview based studies is the flexibility, and greater replicability would undermine this strength (Saunders et al., 2009).

The data collected during the interviews is subject to the time of collection, and hence, offer little reliability. In accordance with Robson's (2002) four threats to reliability, the interviews could have been influenced by any personal bias of the interviewees, the way I asked the

[70] Positivism relates to the research of observable variables that are not influenced by human misinterpretation or bias. Thereby, positivist research aim to provide accurate and undisputable conclusions that are seen as given (Saunders et al., 2016). Saunders et al. (2016:135) propose that positivism seek to "*produce law-like generalisations*". Replicability and consistent findings are pillar stones in this kind of research.

[71] There is a debate about the applicability of reliability and validity to qualitative studies. Lincoln and Guba (1985) propose alternative methods to assess the quality of qualitative research. Namely, i) credibility, are the findings credible? ii) transferability, can the results apply to other circumstances? iii) dependability, will different times yield different results? (Bryman & Bell, 2011).

questions, and how I interpreted the reponses. To minimise these effects, I provided a list of predetermined questions, and asked probing questions during the interviews to gain a better understanding of the responses, and the interviewees received access to the notes from the interview to verify the comments. In addition, I primarily asked open-ended questions to avoid any leading questions any minimise any bias.[72]

Validity

Validity refers to the integrity of the findings, i.e. the credibility of the study (Bryman & Bell, 2011). The theoretical framework from the literature review consists of multiple different, and rather unrelated, sources because the literature does not agree upon one feasible, homogenous method to deter tax evasion. Nonetheless, the theory helps to establish an idea of what works, which I can compare with the data collected from the interviews.

Qualitative studies fail to make statistical generalisations that apply to the population as a whole. However, Saunders et al. (2016) propose two validation techniques to improve the transferability of the study.[73] Firstly, triangulation employs more than one data source or collection method to ensure the independent approaches yield similar results (Saunders et al., 2016). Unfortunately, due to time, resource and sampling restrictions limited the number of interviews, and I was only able to conduct one in-depth interview. The Økokrim interview only provided insight into a couple questions. If time allowed it, it would have been helpful to conduct more interviews with representatives from Skatteetaten to compare the results. Additionally, interviews conducted with corporations would have given insight into their perspective as Økokrim and Skatteetaten offer a one-sided view.

Secondly, participant validation implies that participants receive the data post-collection in order to authenticate the accuracy of the statements, and, if necessary, make any adjustments (Saunders et al., 2016). The follow-up data gave me additional information from the interviewees, which were not yet part of my notes. Allowing them to check the transcript may encourage them to speak freely and not hold back any information they are afraid is subject to misinterpretation. This also seems ethically appropriate.

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[72] I tried to structure the questions in accordance with Saunders et al. (2009) who write that open-ended questions begin with what, how or why. The questions are in Appendix 8.2.

[73] External validity, or transferability, refers to the extent to which the findings of one study can be generalised and transferred to another setting (Saunders et al., 2016). Because the findings are subject to Norwegian laws and institutions, poor transferability is expected.

5. Analysis

To help answer the research question, this part makes a theoretical and empirical comparison using the collected data from the literature review and interviews. Section 5.1 continues to explain law enforcement's approach to discover corporate tax evasion, and is heavily based on the interview with the Subject. The Subject thought individual bounties could bring more cases of corporate tax evasion into the light, yet whistleblowing remains an unexploited resource in Norway. As such, Section 5.2 provides a detailed analysis of whistleblowing in Norway and the U.S., and discusses an alternative where individuals are held liable for failure to uphold a duty to report misconduct. Individual liability is necessary to deter corporate crime seeing how it increases the expected cost of employees in the scope of their employment. Especially because the decision to pursue economic incentives lies with management, which is likely to be involved in the crime, the matter of individual liability is important since it frightens the responsible individuals and encourages them to self-report in exchange for leniency. So, Section 5.3 discusses the matter of individual and corporate liability in Norway. Finally, Section 5.4 consideres the normative implications.

5.1 Empirical detection and preventive measures

Skatteetaten utilises fines, audits, investigations and tax amnesties against tax evasion. In addition, high risk industries, e.g. restaurant, hospitality, construction etc., are more likely to commit more than one corporate crime. As such, different governmental departments collaborate to create A-krim teams (labour crime) that specialises in specific industries with the intent to improve the authorities' expertise of "red flag" industries.[74] If a corporation has committed several crimes, the discovery of one crime quickly reveals other crimes too. Thus, collaboration between different agencies is important to discover tax evasion. Similarly, Skatteetaten receives tips from international agreements as CRS and FATCA.[75] The Subject

[74] The red segment refers to companies that are neither receptive to an audit or guidance from the authorities, and the red firms accept the presence of tax evasion and refuse to collaborate with the authorities. Skatteetaten (2013a) proposes that change in such companies requires the full force of the law. The yellow, green and white segments represent more compliant and cooperative companies. White being the best with full cooperation and non-tolerance for evasion (Skatteetaten, 2013a).

[75] In Dharmapala's (2016) example, an individual FATCA system could increase cross-border tax evasion because FATCA increases the costs to FFIs. In the respective country, tax compliance becomes more costly, and domestic citizens are more

was positive towards exchange of information between domestic and international agencies, which fuels the fear of detection and encourages taxpayers to self-report. Unfortunately, this effect is strongest towards individual tax evasion.

Moreover, the Subject said that two of the greatest faults of Norwegian law enforcement are poor industry insight and knowledge of complex corporate structures. Another pillar stone of a successful leniency program a la Anderson and Cuff (2011) is an apparent high probability of detection. However, poor industry insight and inadquate knowledge of corporate structures severely restrict that probability. The Subject stated that there was a low risk of audits and detection, hence companies were unlucky to be caught.[76] Therefore, the implementation of teams that specialise on specific industries are key to improve their expertise.

The use of audits to deter and detect corporate crime is supported by DeBacker et al. (2015b) who used IRS data and found that an increased audit rate lowers tax aggressiveness and increases tax payments. However, the findings also revealed that firms became less compliant shortly after an audit. Figure 4 visualises the effect. Evidently, a higher audit rate yields a higher effective tax rate. Yet, after an audit, the noncompliance increases, and does not rise again until 5 years after the audit. The authors propose the reason for this is a bomb-crater perception.[77] This implies that the probability of a new audit of the same firm or industry shortly afterwards is extremely small, i.e. the risk of detection is the lowest shortly following an audit, hence firms become less compliant. This was particularly true for firms that were sanctioned compared to firms that received no penalty (DeBacker et al., 2015b). This could imply that sanctioned firms attempt to make up the loss by evading more taxes.

prone to evade taxes. His findings suggest that information reporting increases the cost of financial services, which increases the likelihood that citizens will hold foreign accounts, and, in turn, the opportunities for tax evasion.

[76] Joulfaian (2000) estimated a 3 percent average audit rate for his set of medium-sized corporations.

[77] The name originates from the First World War, when soliders perceived the safest place to hide was in the crater of the most recent bomb because the likelihood that another bomb would hit in the same spot was miniscule.

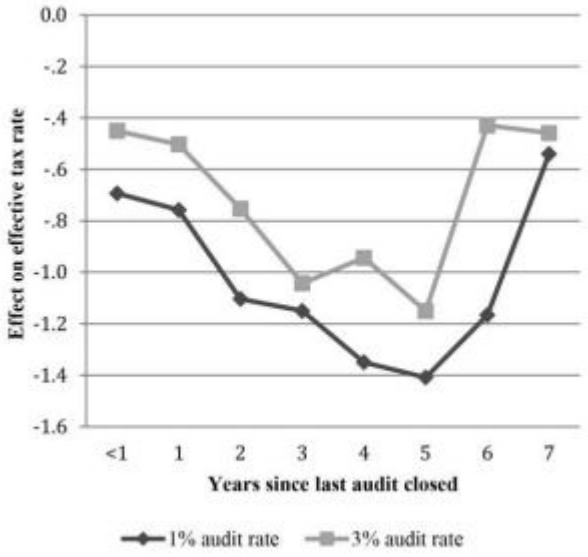

Figure 4: Effect on the effective tax rate subject to the audit rate and years following an audit (source: DeBacker et al., 2015b).

Should an audit find evidence of wrongdoing, one out of two things happens. According to the Subject, Skatteetaten prefers an information approach over a control approach. Information measures, which resemblance self-cleaning, imply an open dialogue with the company where Skatteetaten offers guidance on how to improve and deter future evasion. This requires that the firm is open for guidance and cooperation with the authorities (the yellow, green and white segment). Here, the firm receives a notice in advance that an investigation will take place.

In contrast, a red company receives a surprise control where all potential evidence is collected. Without the collaboration of the firm, access to information and evidence can be one of the major obstacles to an investigation. The control approach requires coercion from the authorities since the firm is not open for dialogue. Such cases are prioritised, but require an abundance of resources, which restricts the number of cases Skatteetaten can undertake. There is a specific tax crime unit allocated to deal with the red segment, and the A-krim team is an important supporting body. These situations can lead to criminal prosecution. In this case, Skatteetaten is instructed to report to Økokrim, who may require assistance from Skatteetaten. However, Økokrim is free to investigate any case and does not require a report. Typically, Økokrim persecutes an individual in a company, but the firm can also receive a corporate fine.

This could be a potential problem. Eriksen and Søreide (2012) write extensively on the implementation of leniency programs in competition law, and the associated difficulties due to a two-track sanction system. The leniency program is subject to the civil track and there are no guarantees that companies that apply for a leniency program will not be criminally prosecuted by Økokrim. There is only an informal, oral agreement between the two institutions that Økokrim will normally not investigate violations of the competition law, unless Konkurransetilsynet reports it. However, Økokrim's involvement undermines the leniency program, and hence, Konkurransetilsynet has reason to exclude Økokrim (Eriksen & Søreide, 2012). A similar relationship between Skatteetaten and Økokrim could cause similar problems. A potential solution is to include leniency programs under the criminal track, and a formal agreement that prohibits Økokrim from investigating cases where leniency is applied for. Unfortunately, this relationship between Skatteetaten and Økokrim remains unclear, but the findings suggest that the latter is open to investigate and criminally prosecute any case.

Moreover, Figure 4 suggests that a higher audit rate will improve deterrence, but because of budget and resource constraints, the audit rate is likely to be somewhat fixed over time. With cartels, enforcement and incentives became substitutes and helped solve the problem of scarce resources. However, Skatteetaten offers few incentives to induce self-reporting. Skatteetaten can remove the surtaxes a taxpayer would normally have to pay in addition to the original tax plus interests. The Subject claimed that if a defendant appeals a verdict, the parties will enter a negotiation where the surtaxes may be dropped. Otherwise, Skatteetaten sets the correct amount owed and is unable to reduce that amount to encourage self-reporting. Alternatively, taxpayers can apply for a tax amnesty to avoid surtaxes and criminal prosecution.

5.1.1 Moderate leniency programs and tax amnesties

Spagnolo (2005) argues that in the absence of courageous leniency programs, moderate leniency programs remain useful. However, moderate leniency programs require positive enforcement actions, which means complete and costless deterrence is unobtainable. They are helpful since the *protection from fines* and *strategic risk* effects are sustained. The former applies providing the benefit of a moderate leniency program exceeds the expected cost of defecting and not reporting, then a rational agent will report. In terms of tax crime, this will apply if a company desists the evasive behaviour. Because the company can be sanctioned

for their previous violations, applying for an amnesty would be beneficial. Although the firm would have to pay restitution, which could discourage an amnesty, it would be costly to cover the tracks of their tax evasion.

However, *strategic risk* was captured against cartels since only the first reporting agent received the moderate leniency, which sustained the rush to report. Section 3.3.4 discussed the possibility that individuals rushed to report to avoid prosecution, but such a case would not satisfy the voluntary requirement of the current legislation. So, the *strategic risk* effect is difficult to obtain in tax matters.

Additionally, Spagnolo (2005) omits the matter of restitution in his model and argues that it is counterproductive to force cartel participants to reimburse the customers. A tax amnesty requires restitution of the tax, which discourages firms to report. Especially if the evasion has occurred over a longer period of time, then the profits gained – and hence the restitution required to repay – will be large. This drastically reduce firms' willingness to self-report. The presence of restitution of tax requires a greater incentive to self-report, and if the removal of surtaxes and interest payments are insufficient, monetary rewards remain the only alternative. Clearly, it makes no sense to grant evasive firms a percentage of the recovered tax they previously evaded. This encourages tax evasion and makes the scheme exploitable. The subject of restitution is worrying, and it seems more sensible to offer a percentage of the collected tax to a whistleblower.[78] In this case, the state increases the tax revenue, and deters tax evasion as managers fear being reported by an employee.

Skatteetaten offers amnesties on an on-going basis, which contradicts the theory that suggests amnesties are ideally a one-time offer. This could signal that Skatteetaten is unaware of the theory. Besides, the Subject revealed that although the legislation refers to the "taxpayer", it is uncommon that a corporation applies for an amnesty. On the rare occasion when it does happen, it typically involves personal tax evasion by someone within the firm, e.g. commission income hidden abroad. He considered tax amnesties very helpful to deter individual tax evasion, but less effective towards corporate evasion. For example, if the scheme has occurred over a long period of time, the firm may not be able to repay the restitution without facing ruinous consequences, which discourages an amnesty application.

[78] Spagnolo (2006) writes that 10 percent of the recovered tax funds, in the U.S., was offered to whistleblowers. Section 5.2.1 shows that this has increased to 15 to 30 percent of the recovery under IRC § 7623(b). A review of the scheme over the past 3 years suggests that it is both popular and successful.

This is more applicable to smaller companies – especially those in the red segment. In addition, the Subject indicated that the the tax enforcement communities were somewhat dissatisfied with tax amnesties because taxpayers could pre-empt the authorities by applying for an amnesty, which caused difficulties with the evaluation of evidence.

The Subject later discussed the topic of tax amnesties and large corporations with his colleagues who worked within the area. They said the legislation is simply inefficient and unsuitable for corporations. Multinational companies can easily utilise a large legal grey area and adopt legal cross-border tax structures to reduce taxation. They further argued that a potential solution requires a legislation amendment and global action across multiple jurisdictions. The latter is extremely difficult to implement, but CRS and FATCA signal a collective movement in the right direction. In essence, corporations that operate abroad have little reason to fear detection, and hence, to apply for a tax amnesty. In addition, it remains unclear if Økokrim is free to investigate and criminally prosecute companies that already applied for a tax amnesty with Skatteetaten, similar to how Økokrim undermines the leniency program offered by Konkurransetilsynet. An informal agreement not to investigate does not suffice if the aim is explicit transparency and predictability.

Besides, an underlying assumption of Spagnolo's (2005) self-financing system is that the fine administration occurs costlessly, which he argues is unfeasible if the reward is financed through taxation. He claims it is unrealistic and not politically viable to spend honest taxpayers' money to fund a reward program for offenders, which could cause a social outcry. However, we have later seen that whistleblowers can receive a percentage of the recovered amount.

5.2 Whistleblower program

The literature review suggests that the agency cost arising from whistleblowing can wipe out cartels. That agency cost between the principal and agent should be applicable to corporate crimes in general given that individuls can receive a bounty for whistleblowing. According to the Working Environment Act § 2 A-1, an employee has the right to blow the whistle on unacceptable circumstances in the workplace. However, there is much social stigma surrounding whistleblowers as they can be perceived as traitors (Transparency International, 2009).

Retaliation against whistleblowers is not uncommon. For example in 2016, Politiets Fellesforbund (Police Union) publically announced that they discouraged whistleblowing in the police because they acknowledged it as a health hazard. Identities are not kept anonymous, whistleblowers can lose their job or are harrassed in the workplace (Søreide, 2017a). Politiets Fellesforbund identified sick leave, relocations and conflits as typical consequences of blowing the whistle. One whistleblower claimed that the price for blowing the whistle was exclusion from the labour market (De Rosa & Engen, 2016). In accordance with the Working Environment Act § 2 A-3, retaliation against a whistleblower is prohibited, but the leader of Politiets Fellesforbund argues that the legislation works best in theory. For example, Sweden introduced a legislation in 2017 that explicitly protects whistleblowers against reprisals (Varslingsutvalget, 2018).

The consequences of whistleblowing discourage individuals to act, and a monetary compensation could encourage action. However, representatives from Skattedirektoratet was unaware of any special whistleblower system that relates to tax crime in Norway. Although Skatteetaten receives tips about tax matters that can lead to control and ultimately civil sanctions, the tipsters receive no monetary rewards. The Subject used an example where dissatisfied employees are prone to tip the authorities about unacceptable conditions in the workplace. A monetary bounty could intensify the incentive to blow the whistle on tax crime.[79] He believed that whistleblowing programs and rewards could motivate employees to report and bring forth more corporate cases.

In a report for Varslingsutvalget (whistleblowing association), Oslo Economics (consultancy firm) acknowledges that economic incentives, or monetary rewards, are untraditional in Norway. The Subject was skeptical from a moral point of view on this particular topic, which could demonstrate the political unfeasibility of rewards previously mentioned by Spagnolo (2005). The findings of a Norwegian survey conducted by Andås et al. (2017) suggests that the propensity to whistleblow is independent of rewards.[80] Varslingsutvalget

[79] Appendix 8.3 shows the types of corporate misconduct reported via internal company mechanisms, and it shows that tax is the third lowest.

[80] Their survey is part of a previous master thesis at NHH. It also reveals that few believed they would receive the reward, more so for those with a high reward. For more information, see https://www.magma.no/bor-varslere-belonnes (in Norwegian). The thesis concludes that economic rewards will not increase whistleblowing in Norway (Solum & Andås, 2015). Another thesis suggests that whistleblowing is the most important component in a compliance-system to prevent and uncover management controlled corruption, with an emphasis on external channels (Vik & Vika, 2016).

(2018) proposes that the authorities should consider increasing the amount of redress in cases of retaliation against whistleblowers, which are relatively modest, instead of offering bounties. According to Wik and Sortland (2013), the redress claims for breaches of the Working Environment Act § 2 A-3 in Norway roughly ranges between NOK 100,000 to 150,000, which hardly compensates a whistleblower sufficiently.

Although managers have an obligation to take whistleblower inquiries serious, Søreide (2017a) questions what makes them actually do so. She states that sometimes it could be in the best interest of the manager to silence the whistleblower. An incentive based system could encourage managers to take whistleblowing more serious. A 2016 Norwegian study revealed that only 36 percent of the respondents thought it helped one way or another to blow the whistle. In comparison, the figure was 49 percent in 2010 (Trygstad & Ødegård, 2016). This could suggest that whistleblowers are not taken seriously, and that it is worsening. Oslo Economics supports Søreide's point with what they call the "incentive problem", i.e. the employer and responsible parties will often face higher costs than benefits by fixing the problem. Thereby, the employer may attempt to stop or scare the whistleblower (Varslingsutvalget, 2018).

Criticism towards the use of rewards often refers to the population's moral principles. A fear that rewards will dilute the moral reasoning for whistleblowing, and a drop in citizen's likelihood of blowing the whistle in cases where there are no rewards, dispute the use of monetary rewards.[81] There is however, little evidence that moral incentives are weakened by the use of economic incentives (Oslo Economics, 2017). The U.S. uses a modern system where whistleblowers can receive millions in reward for their actions. On the other hand, Europe's approach is split between the United Kingdom (U.K.) that leans towards an American approach and Germany who is more reserved towards the use of rewards, mainly due to previous negative experiences with the Gestapo and Stasi system.[82] Norway has a

[81] For example, if monetary rewards are available for a crime, it may discourage individuals to prevent a crime from happening. Instead, they will wait until the crime is commited, then report to receive the prize. In this sense, rewards would have no deterring effect. However, if a manager knows that employees will blow the whistle, he may choose not to commit a corporate crime, which does have a deterrence effect.

[82] Birthe Eriksen (University of Bergen) stated that the U.K. has the most advanced and modern legal status in Europe in relation to whistleblowing. She argues that the Norwegian Working Environment Act is second only to the U.K., but that it lacks a fundamental understanding about whistleblowers, primarily general knowledge about the topic and the system around the application of the rules (Jacobsen, 2012).

varying degree of whistleblower protection, and offers no anonymity guarantee nor incentives for whisteblowers to disclose violations (OECD, 2016).[83]

There is certainly a heated ethical debate surrounding the use of whistleblowers, particularly if rewards are introduced as well. One argument is that employees have a duty of loyalty to their employer, which is breached if they whistleblow, hence the "traitor" reference. Yet, if the employer commits gross tax evasion, does he not first betray society? Should it be considered a betrayal to report that employer? Surely, there exsits a line where the duty of loyalty towards the employer ends. A similar problem relates to the confidentiality of an employee. This ethical debate does not belong further in this thesis, but offers food for thought. Besides, the Working Environment Act does not mentioned such a duty.

To sustain an effective whistleblower program, it is key to create awareness about the employer's and employee's rights. Unfortunately, according to the 2015 OECD Survey on Business Integrity and Corporate Governance, only half of the respondents conducted awareness campaigns in the public sector (OECD, 2016). Awareness is key so that if an employee discovers a violation, he should be aware of his rights and what to do with the information, e.g. who does he first notify? Naturally, this requires the organisation to have well integrated whistleblower channels, a possible mandate imposed on firms through negotiated settlements in accordance with Arlen (2011). Alternatively, whistleblowers can directly turn to the state. For example, the U.K. HM Revenue and Customs has a website and fraud hotline where individuals can report tax evasion.[84]

In Norway, the Working Environment Act does not mention whistleblower channels, only that the employee's approach to whistleblowing should be justifiable. That being said, § 2 A-3 states that there is an obligation to prepare routines for internal whistleblowing, but what happens when the manager is both in charge of the internal channels and the corporate

[83] According to OCED (2016), anonymous disclosure can illustrate distrust in the system and the intergrity of the corporation. Although anonymity offers a safe passage to report, others are skeptical towards the extent of the protection. It appears evident that whistleblowers do face negative social, and possible financial, consequences from blowing the whistle. So it is unsurprising that an absence of anonoymity drastically reduces the appeal of whistleblowing.

[84] For a study on external versus internal whisteblowing channels, see (Dworkin & Baucus, 1998) who find that external whistleblowers provide greater evidence of misconduct and more effectively promote organisational change. However, the extent of retaliation against external whistleblowers are greater than internal whistleblowers, and the former has a shorter employment in the organisation relative to the latter.

crime? Then the manager will have no reason to take the inquiry serious. Thus, external whistleblower channels could be necessary to provide employees an alternative option.

5.2.1 IRS Whistleblower program

Internal Revenue Code (IRC) § 7623(b) was added to the Tax Relief and Health Care Act (TRHCA) in 2006, which improved the conditions of whistleblowers' award program. If the criteria is met, the whistleblower is eligible for a reward ranging from 15 to 30 percent of the collected tax, with no maximum dollar restriction.[85] Fiscal Year 2018 set the record for both the amount collected and awards paid. The total award payout[86] for FY 2018 was $312 million, 21.7 percent of the $1.4 billion tax collected, and split across 217 recipients, 31 of which concerned IRC 7623(b). Table 1 illustrates the amounts collected and awarded under IRC § 7623 from FY 2016-18. In comparison, the Whistleblower Office has collected $5 billion and paid out awards totalling $811 million since 2007 (IRS, 2018b). With roughly half of that collected and awarded in the last 3 years, the program becomes increasingly popular. The amounts in Table 1 seem to vary from year-to-year, but both the number of IRC § 7623(b) awards and the percentage of proceeds collected increase. A larger payout could encourage potential whistleblowers to use the program. Besides, the program appears to give out many awards, at least half of the claims result in an award. However, the IRS (2018b) report also shows that it takes 7 to 9,5 years to process the awards over the same time period. Actual whistleblowers for the big cheats are typically *"dissatisfied middle-ranking employees in big companies"*, investors or business associates (Ellis, 2010).[87]

For example, Bradley C. Birkenfeld received a $104 million award (26 percent of the imposed penalty), and a two years prison sentence, for blowing the whistle on the Swiss bank USB. The case undermined the secrecy of the Swiss banking system, and USB provided account information on more than 4,500 American clients. In addition, the

[85] For more information about IRC 7623(b) see https://www.irs.gov/compliance/internal-revenue-code-irc-7623b. If the case does not exceed the threshold of $2 million, the whistleblower may receive a discretionary award in accordance with IRC 7623(a). The majority of awards in FY 2018 was small (less than $2 million) and related to IRC 7623(a).

[86] The total amounts of awards figures are before the sequestration reduction, which IRS (IRS, 2018b) explains as a mandatory reduction in expenditure that also applies to IRC § 7623. In FY 2018, the required reduction was 6.6 percent, or $20 million, of the total amount payable.

[87] For smaller cases, i.e. IRC 7623(a), there will be a mixture of informants, e.g. ex-spouses and ex-employees. However, the whistleblower is required to fill out a detailed form of the tax evader, so some connection between the two is required (Ellis, 2010).

disclosure of account information caused panic among wealthy Americans with wealth hidden abroad, which resulted in 14,000 tax amnesties applications. The whistleblowing led to the collection of more than $5 billion in unpaid taxes through tax amnesties (Kocieniewski, 2012).

	FY 2016	FY 2017	FY 2018
Total Claims Related to Awards	761	367	423
Total Number of Awards	418	242	217
Total IRC § 7623(b) Awards	18	27	31
Total Amounts of Awards[2]	$61,390,910	$33,979,873	$312,207,590
Proceeds Collected	$368,907,298	$190,583,750	$1,441,255,859
Awards as a Percentage of Proceeds Collected	16.6%	17.8%	21.7%

NOTE: Data reported as of September 30, 2018.

Table 1: Amounts collected and awards under IRC § 7623, FY 2016-2018 (source: IRS, 2018b).

5.2.2 Failure to Act

As an alternative to rewards, Søreide (2017a) writes that "*if carrot is appropriate, then whip is also an alternative*"[88], where she refers to a personal liability for failure to act following discovery of misconduct. That is, a penalty for failure to report a transgression could have a stronger effect than a reward. If Norway introduce a contractual duty that states employees or employers can be held personally liable for failure to report a crime, then this could induce whistleblowing. Knowing that individuals have an obligation to act and report tax evasion, a manager would be less inclined to commit it. In addition, it would justify their actions and possibly mitigate the stigma around whistleblowing since it is now their legal duty to report (Søreide, 2017a).

However, a failure to act could be difficult to prove.[89] There could be digital evidence of the knowledge, but the authorities would have to allocate already scarce resources to investigate this. It seems a waste to use resources on an already resolved case that otherwise could be

[88] Translated from the orginial text in Norwegian.

[89] In the case of R v Pittwood (1902) 19 TLR 37, the defendant was convicted of manslaughter because he failed to fulfil his contractual duty to close the railway gate, which caused a horse and cart driver to be killed. In this case, it was evident that he failed his duty, but corporate cases are probably harder to prove. A contractual duty to report information however is more difficult to prove. For more information about the case, see https://www.lawteacher.net/cases/r-v-pittwood.php.

spent investigating another case. That being said, it is plausible to think the legal duty is simply an incentive to justify the report although the employees know it will not be enforced.

There is also an external party that could be held responsible – auditors. Numerous theses have researched auditors as society's trustees and gatekeepers. For example, Hagelund and Sandvik (2016) write that audit fees can affect auditors' independence, and that auditors can ignore conflict of interests and let fraud go unnoticed. Their literature review suggests auditors, in some cases, accept a negative reputation in order to retain a profitable customer.[90] When Wells Fargo employees were caught opening false accounts, their auditor, KPMG, was criticised for their failure to discover the fraud. Similarly, when auditing FIFA, KPMG gave a clean audit report. Hageland and Sandvik (2016) further explain that the legislations and framework surrounding auditors' responsibility to uncover and report corporate crime is ambiguous.[91] A stronger framework and clear guidelines could deter more corporate crime, but also greater auditor liability could discourage auditors to ignore transgressions committed by profitable customers.

5.3 Individual and corporate liability

Whistleblowing is a compelling instrument to self-report corporate tax evasion after the fact. Surely it would be more sensible to prevent the crime from happening in the first place. Whistleblowing has a sound deterrence effect in the sense that violators are aware of the possibility of whistleblowing, which could prevent a crime. However, the literature review also suggests that corporate crime is deterred through individual liability where the expected cost exceeds the benefit. The meeting with Økokrim touched upon the matter of liability. According to the Tax Administration Law §§ 14-3 and 14-6, surtax and sharpened surtax, respectively, are imposed on the taxpayer. However, in a corporate setting, the taxpayer is the firm, which suggests that the civil track does not hold individuals liable for corporate misconduct. For example, a CFO who underreports tax is not held liable since the taxpayer is the corporation, not the CFO. That is, unless *mens rea* is proven and Økokrim prosecutes

[90] A prime example of questionable auditor independence is that of the Enron scandal and Andersen & Company, for more information see https://www.nytimes.com/2002/01/15/business/enron-s-collapse-the-auditors-who-s-keeping-the-accountants-accountable.html

[91] See https://lovdata.no/dokument/NL/lov/1999-01-15-2#KAPITTEL_4 for further information about the Auditors Act (in Norwegian). Particularly § 4-1 explains the general demands in terms of an auditor's independence, objectivity and ethics.

him in the criminal track. In accordance with Arlen (2011), individuals must fear individual liability to deter corporate crime, including corporate tax evasion.

All sanctions against individuals go through the criminal track, and the TGS case demonstrates that individuals can be prosecuted. Økokrim prefers to prosecute individuals and spare innocent shareholders, employees and customers who all suffer from a corporate sanction.[92] However, it is extremely difficult to identify the correct culprits and determine who benefits from the crime. For example, do you prosecute the individual who unknowingly committed the crime or the individual who made the decision? Additionally, complex corporate structures and a high burden of proof makes it challenging to hold individuals liable. Therefore, countries, with the U.S. at the tip of the spear, have adopted a more practical solution. Negotiated settlements, which remains absent in Norwegian legislation, dominate the criminal settlements in the U.S. This collaboration between prosecutors and wrongdoers determines the sanction based on the corporation's previous and future efforts to deter crime, and it could be sensible to implement this in Norway (Søreide, 2017b).

A former master thesis investigated 63 cases of negotiated settlements in Europe and found that individual liability was imposed in only 22 percent of the cases. Still, individuals were often suspects and charged, but their findings suggest that negotiated settlements remove the individual liability. If individuals are not held liable, their expected cost of the crime declines, and individuals are more prone to commit corporate crimes. However, it remains important to have individual liability, although it is difficult to follow up, since it has preventive effects and encourages management to adopt compliance mechanisms (Flytøren & Haram, 2018).

Søreide (2015) writes that "*with sufficient evidence, there will be a preference for holding the individual responsible for criminal acts*". Yet, if the authorities fail to identify the responsible individual, the corporation is penalised (Søreide, 2015). Although individuals are preferably held liable, corporations are the victim more frequent than not. In comparison to the U.S., Norway has weaker vicarious liability, but it became stronger with a 2005 law that

[92] The Penal Code § 15 about Complicit Responsibility ("medvirkeransvar") states that a penalty also affects the person who contributes or is complicit to the violation, unless otherwise specified, and could hold individuals criminally liable.

came into effect in 2015.[93] Corporate liability incentivises management to implement preventive measures a la Arlen (2011), which is critical to disincentivise criminal conduct.

The data suggests that although individuals are preferably held liable, it is difficult to ensure. Instead, corporations typically become the target. In comparison, the theory requires a reliable combination of both corporate and individual liability to deter corporate crimes. Thus, there is a discrepancy between theory and reality in terms of individual liability. In theory, it is easy to say Skatteetaten and Økokrim should announce a credible effort to hold individuals liable, similarly to what the DOJ did with the Holder memos. In actuality however, resource constraints, and possibly inadequate industry understanding, restrain the authorities' ability to enforce this. Again, a possible solution is to utilise a cost-efficient resource with excellent industry knowledge – the employees.

5.4 Normative implications

"One should obviously be careful about drawing policy conclusions from the theoretical literature in an area where our empirical knowledge is by necessity so uncertain" (Agnar Sandmo, 2004:26)

Sandmo puts it precisely, that we must tread carefully when exploring a subject where our empirical knowledge is vague. That being said, the analysis has exposed several points of improvement that could help reduce corporate tax evasion in Norway, at least in theory.

Neither Økokrim or Skatteetaten possess sufficient resources to deal with all cases of corporate crime in Norway. In fact, the probability of detection is low, but greater fines imposed on violators could discourage tax evasion. Luckily, corporate sanctions are being revised. It became evident from the interview with the Subject that better industry knowledge and corporate structures are also necessary. An overall greater focus on tax evasion would be useful, and a starting point would be to estimate the size of the tax gap and non-compliance in Norway, which could be used as a reference point to determine the effects of future policies.

[93] The U.S. exercises a broad scope of strict *respondeat superior* and corporations are commonly held liable, even if the different DOJ memos, e.g. the Holder memo, urge prosecutors to pursue individuals to increase the expected cost of a crime.

Law enforcement's primary incentive tool, tax amnesties, must be reformed to better suit corporations. Currently, the primary focus is individual tax evasion. Skatteetaten should consider limiting the availability of such corporate tax amnesties so firms do not postpone the application. The fact that tax amnesties are available at all times could indicate that Skatteetaten is ignorant of the theory behind the use of amnesties, which would be wise to take into account.

In any case, the most sensible option seems to utilise individuals and let them uncover corporate crime on behalf of law enforcement through whistleblowing. However, whistleblowing would require a complete transformation of how whistleblowers are perceived, and the Norwegian society must acknowledge their value to society. A pro whistleblower culture could even mitigate the negative effects of absent anonymity. Skatteetaten should study the IRS Whistleblower Office and FCA programs, and possibly introduce the idea of monetary rewards to whistleblowers to compensate them for their aid to the community. Certainly some political implications are omitted in this thesis, but one can assume that Norway, being outside the EU, has more flexibility to apply either a U.S./U.K. or German approach. In addition, whistleblower channels need to be implemented and advertised.

In accordance with Arlen (2011), the authorities should better induce corporations to implement preventive and policing measures. A stronger vicarious liability effect has already come into effect, which according to theory, should induce preventive measures. However, for corporations to optimally police, the authorities must clearly demonstrate that firms that do not police are sanctioned harsher than those who do. Individual prosecution is also necessary to disincentivise employees to commit corporate tax evasion in the first place.

6. Final notes

6.1 Conclusion

The objective of this thesis is to answer the research question: how can economic incentives to self-report reduce corporate tax evasion in Norway? To reach a conclusion, I have conducted a thorough literature review on corporate crime and economic incentives, and two interviews.

The literature review has identified features that have resulted in successful implementation of leniency programs in competition law. First, Arlen (2011) promotes corporate preventive- and policing measures to decrease the value of corporate crime and increase the probability of detection, respectively. Her literature does not refer to self-reporting, but offers a broader view of corporate crime and crucial preventive implications that justifies its place in this thesis.

Second, Spagnolo (2005) investigates leniency programs to create distrust between cartel participants and induce self-reporting to the authorities. His "courageous leniency program" is difficult to apply to tax matters because the relevant agents in cartels and tax crime differ. However, he argues that moderate leniency programs also induce self-reporting, and such programs resemble tax amnesties, which are used by Skatteetaten. The findings suggest tax amnesties are inefficient since companies have little incentive to apply for one.

Third, Aubert et al. (2004) focus on the individuals within a cartel member, and their theory is easier applied to tax crime. They argue that bounties offered to individuals that blow the whistle on their employer create an agency cost between the principal and the agent, which could dissolve a cartel since the principal has to buy the fidelity of the agent. This extra cost to corporate crime has a strong deterrence effect. Besides, whistleblowing utilises a cost-efficient resource, namely the individuals within violating firms. And, the whistleblowing option alone could have a deterrence effect if the manager knows the employees will blow the whistle.

Furthermore, the interviews with Skatteetaten and Økokrim provided good insights into law enforcement, and what is done empirically to fight corporate tax evasion. The overall impression was that corporate tax evasion receives little attention in comparison to

individual tax evasion. This is particularly clear with the use of tax amnesties, where the legislation is unsuitable to target corporations. Overall, the collected data suggests that there are few carrots to offer corporations to self-report tax evasion.

Based on these findings, economic incentives have the potential to induce self-reporting, which could reduce corporate tax evasion, in the sense that it persuades rational agents to pursue the greater payoff. However, leniency programs such as amnesties are unlikely to reduce corporate tax evasion as it currently stands and require reform. Instead, the use of whistleblowing could induce employees within noncompliant firms to self-report to the authorities. The implications of this is that Skatteetaten and Økokrim should target employees to detect misconduct on their behalf, which the findings suggest could reduce corporate tax evasion. In order to do so, whistleblowing programs require amendment, and Norway must promote a culture in support of whistleblowers.

6.2 Further research

Investigating a previously neglected research topic leaves many suggestions for further research. Some topics that I have come across and call for further research are as follows.

First, I have paid attention to the standpoint of law enforcement. An exciting alternative is to interview or survey corporations to get an estimate of tax moral, tax evasion and incentives that induce self-reporting.

Second, I have assumed that tax evasion occurs in-house. However, external agents such as tax havens, lawyers and FFIs play a role in corporate tax evasion, yet remain absent in this thesis. The issue of cross-border tax evasion and global, collective action relative to economic incentives to overcome tax evasion require further research.

Finally, the IRS Whistleblower Office was introduced in 2006 instead of including tax fraud under the FCA's *Qui Tam* program. A comparative study between *Qui Tam* and whistleblowing could help determine which is more suitable to battle corporate tax evasion.

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8. Appendix

8.1 Table of concepts

Concept	**Definition**
Corporate and individual liability	Corporate and individual liability refer to whether the company or individual, respectively, is held liable for an offence. Both liabilities can have a deterrence effect. For example, individual's expected cost of crime increases if they are held individually liable for a crime. If corporations are held liable, they have an incentive to prevent corporate crimes.
Corporate prevention and policing	Arlen (2011) describes prevention measures as *ex ante* interventions to either lower the expected benefit of the crime or increase the direct costs. For example, structure compensation policy to make crime less appealing. Moreover, she describes policing measures as interventions that increase the probability of sanction. Examples are *ex ante* monitoring and *ex post* investigation and collaboration with the authorities.
Criminal and civil track	Norway: Criminal prosecution implies that infringements of the Penal Code §§ 378 to 381 has incurred, where the taxpayer has provided incorrect or incomplete tax information that yields a tax advantage. Criminal sanctions are fines and imprisonment up to 6 years. The Finance Department has issued an instruction on when to report a case to the prosecutors, this includes other circumstances other than breaches of the Penal Code. See https://lovdata.no/dokument/INS/forskrift/2018-12-14-2158#KAPITTEL_3. Criminal cases are the domain of the prosecutors, Økokrim. If the case follows the civil track, it is dealt with by Skatteetaten under the Tax Administration Law (skatteforvaltningsloven). See

	https://lovdata.no/dokument/NL/lov/2016-05-27-14#KAPITTEL_14. Tax law (civil) sanctions, e.g. surtaxes can be imposed in accordance with §§ 14-3 to 14-6. Surtaxes are only imposed on the taxpayer, which in this thesis refers to the corporation. What separates the criminal and civil track is the extent of criminal intent, or *mens rea*.
Marginal deterrence	More serious crimes should be punished harsher than lesser crimes. It can deter harmful acts because the sanction exceeds that of a lesser crime.
Mens rea	A guilty mind. Criminal intent, the intention or knowledge of wrongdoing that constitutes part of a crime. In criminal prosecutions with a high burden of proof, it can be very difficult to prove *mens rea*.
Negotiated settlements	An out of court settlement between the defendant and the authority. It resolves cases faster and typically imposes fines on the defendant. It can also impose mandates, or duties, on the defendant to increase future compliance. Negotiated settlements open a dialogue between the authority and the defendant, where the extent of misconduct and the size and form of sanction imposed are negotiated. Such an approach receives criticism for allowing the violator to negotiate their own sanction. Although Norway has forms of pre-trial settlements, negotiated settlements are not practiced. Out-of-court settlements in accordance with the Dispute Law (tvisteloven) chapter 6, 7 and 8 allow for mediation by a third party. Criminal cases can go through Konfliktrådet (the Mediation Service).
Respondeat superior	A party is responsible, and has vicarious liability, for acts of their agents, e.g. the employer is responsible for the acts of the employees in the scope of their employment.
Self-cleaning	A company makes an effort and implement compliance mechanisms to prevent future

	corporate crime by "cleaning the business".
Self-monitor	The company monitors and evaluates its compliance behaviour. Monitoring is one of the duties recommended by Arlen (2011) to detect corporate crime.
Strict liability	The defendant is held liable for the consequences of an activity absent any fault or *mens rea* by the defendant.
Vicarious liability	Implies that liability is imposed on the defendant for the acts of someone else. See *respondeat superior*.
Whistleblow(er)	A whistleblower is an individual who blows the whistle to notify about unacceptable circumstances in the work place such as criminal activity, and reports to the authorities. The U.S. IRS Whistleblower Office was established in 2006 to process tips about possible tax crime in their workplace. In Norway however, the whistleblower programs are less developed. For example, the U.S. offers anonymity and rewards whistleblowers for their action, whereas Norway offers neither anonoymity or rewards to protect or compensate whistleblowers.

8.2 Skatteetaten interview

The Skatteetaten interview was audio recorded. Prior to the interview, I was approved by NSD – Norwegian Centre for Research Data to record. However, I experienced technical difficulties afterwards and the audio recording was unaccessible, which is why it is a summary and not a complete transcript. The Subject has later approved of the summary. The Økokrim meeting was not audio recorded, nor is a summary provided since we only discussed some background information and kept it extremely informal. They also received a document with references made to the interview and edited any incorrect information.

What: Interview with a Skatteetaten representative ("the Subject").[94]

[94] The interview Subject wished to remain anonymous to express his or her own opinions freely.

Where: Skatteetaten's offices in Bergen: Nonnesetergaten 4, 5015.

When: 10 am.

Why: Discuss different topics revolving tax evasion in Norway.

1. **Please explain how voluntary correction (frivillig retting) works.**
    a. **Does it apply to corporations?**
    b. **Do corporations make use of it? Why, why not?**

If you have income or wealth hidden abroad, you may come forward and report to Skatteetaten to avoid surtaxes, i.e. a full amnesty, and criminal prosecution. However, you do have to repay the full amount of what you originally owed plus interest. Voluntary correction typically concerns individuals, and not corporations. In fact, the Subject stated that the system was not intented for corporations although firms are eligible since the law state "the taxpayer". On the rare occasion that a corporation does apply, it typically revolves around individuals within the organisation who, e.g. have hidden commission income abroad, which would affect the corporate tax amount.

Corporations seldom apply for amnesties chiefly because i) they do not necessarily have any reason to fear detection and the authorities, especially if the corporation in question operates aborad, and ii) firms may not be able to repay what they owe if the evasion has occurred over a long period of time. Then, the owed tax may have reached a size that has ruinous consequences for a company. Alternatively, a rule of thumb for smaller corporations is that they belong to what the Subject refers to as the "red segment"[95]

2. **What characterises corporate tax evasion, and how does it work empirically?**

Skatteetaten's voluntary correction/amnesty is aimed towards individuals. However, the same rules apply to corporations, but the agency has not put any effort towards this area. A reason for this is because experience shows that the tool is most relevant for individuals.

3. **How is corporate tax evasion detected?**

Predominantly, Skatteetaten detects tax evasion through audits and investigations of certain industries. The industries to be researched is determined by a team of analysist. In addition,

[95] The red segment refers to companies that are neither receptive to an audit or guidance, these companies can accept evasion to occur.

there are certain industries more subject to corporate crime, e.g. construction and hospitality. Especially in terms of employment contracts of foreigners.

There is also a A-krim team (labour crimes) that aims to improve the expertise of particular red flag industries. The Subject stated that although they do not directly relate to Skatteetaten, it is not uncommon that a corporation guilty of labour crimes will be guilty of other forms of crime, e.g. tax evasion, too. There is an important collaboration between the different agencies. International agreements such as CRS and FATCA are also important, which Skatteetaten receives tips from. In addition, an income determination is established for the large companies within an industry, and these receive a closer follow-up, which typically refers to a dialogue with the companies in question. However, the Subject pointed out that tax evasion is chiefly detected through an investigation.

4. **What happens after evidence of wrongdoing is found?**

If an investigation has found evidence of wrongdoing, there are typically two approaches. Either the corporation in question is cooperative, or not. The latter requires unannounced audits with control measures where the authorities use coercion to collect all necessary information. These cases require considerable resources and may lead to charges. The A-krim team is of particular importance when dealing with the red segment. Such cases are prioritised and ample resources are allocated to this area. There is also a tax crime unit allocated to these cases. However, due to resource limitations, Skatteetaten can deal with a restricted amount of cases. The Subject stated that it is very difficult to approach firms that are not cooperative.

On the other hand, Skatteetaten prefers an information measure approach where the firm receives a notice in advance that an investigation will take place and that evidence will be collected. This approach bears a resemblance to self-cleaning, and occurs with firms outside the red segment (yellow, green and white) that are open to dialogue and guidance. Although an information measure approach is simpler, it still requires abundant resources to help firms improve. If the amounts are sufficiently large, Skatteetaten should report the case to Økokrim since the case will become a criminal matter. Økokrim may require assistance from Skatteetaten.

5. **Why do corporations evade tax – how do the individuals responsible benefit?**

For this question, it is important to distinguish between small-medium and large corporations. In multinational companies, personal gain will not have a prominent importance relative to smaller companies. The Subject proposed that (large) corporations evade tax because there is a culture where tax is considered an expenditure that ought to be minimised. Here, the individuals responsible for the crime have little or no gain, and the Subject stated that employees are not necessarily aware that they do not benefit.

Typically, there is one person that run the scheme. However, it is difficult to hide the action from other employees that actively engage in the corporation.

6. **What preventive measures are implemented to deter corporate tax evasion in Norway?**
    a. **Do tax evaders have an incentive to come forward?**
    b. **Can Skatteetaten offer any incentives, e.g. less tax to repay?**
    c. **How would you evaluate the success of tax amnesties?**
    d. **What are the strengths and weaknesses of Norwegian law enforcement in relation to tax evasion?**

Again, analysis and investigations are the main tools of Skatteetaten. The Subject referred to risk analyses taken by each firm would have a preventive effect since most firms will pay the correct amount of tax. Additionally, agreements between agencies and jurisdictions help. Although focused on individuals, financial transparency across borders help reveal hidden wealth and frighten violators to come forward. The Subject was positive to such agreements and thought them an effective tool.

In terms of tax amnesties, the Subject was positive that they work in terms of individuals. In relation to corporations however, they are unlikely to work. Firms have little reason to fear the authorities and detection. They are rarely used due to the reasons stated previously.

Nor do Skatteetaten have any particular incentives to offer anyone willing to come forward. If negotiations are entered, it is possible to avoid surtaxes. But Skatteetaten sets the correct amount of tax and does not have any power to reduce the owed amount to incentive self-reporting.

In relation to the strengths and weaknesses, the Subject stated the following. Access to information and evidence is a major obstacle. In addition, Skatteetaten has poor industry

insight and knowledge of complex corporate structures. The expertise does not suffice, which is why concepts such as A-krim is a good approach to improve the expertise within specific industries. An additional strength relates to the information measure, which according to the Subject, has a "dialogue perspective" that emphasise an open dialogue between authority and violator to help and improve corporations to better their structure and policies to avoid future transgressions.

7. **What difficulties do Skatteetaten face in cases of corporate tax evasion?**

(Skipped this question. Sufficiently covered previously – relate to resource restrictions, access to information and lack of expertise)

8. **What pre-trial agreements do Norwegian law enforcement employ?**

A firm has the alternative to appeal a verdict, to which a negotiation will be open with the authority. Then the additional fees can be negotiated to be removed.

9. **Are monetary rewards to self-reporters realistic/feasible?**
    a. **How can whistleblowing programs influence corporate tax evasion?**

There are no direct monetary rewards, firms are only able to avoid surtaxes.

The Subject believed that whistleblowing and bounties would incentivise employees to come forward and report more cases of corporate crime. Because it is difficult to hide a crime from others within a firm, the number of informed employees will continue to grow. Particularly colleagues that dislike one another are likely to blow the whistle without a bounty, this would be intensified if they could gain something other than personal satisfaction from reporting a co-worker.

Notably, the Subject was skeptical from a moral point of view on this topic.

10. **What are the roles of Skatteetaten and Økokrim, how is the investigative process?**
    a. **What is the difference between civil- and criminal sanctions?**
    b. **In relation to tax evasion, is there a two-track system similar to competition law?**

There is a cooperation agreement between Økokrim and Skatteetaten, and the latter has instruction to report relevant cases to Økokrim. Most cases originate with Skatteetaten, who

will report criminal cases to Økokrim, e.g. the size of tax evaded (gross tax evasion) can spark criminal sanctions. Individuals who receive additional fines always go through the criminal track, whereas corporations may receive the additional fines under civil sanctions.

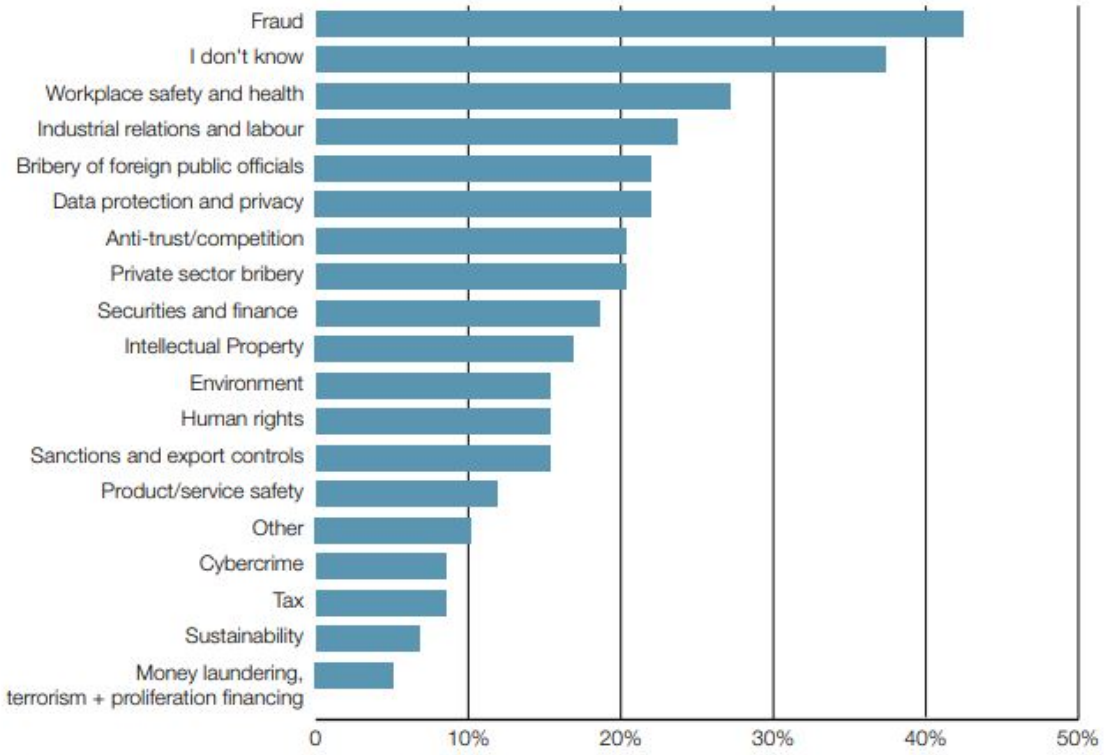
Similar to case with Konkurransetilsynet, Økokrim can initiate their own investigation without any reports from Skatteetaten.

11. Briefly, what is the Norwegian tax compliance and tax gap?'

NOK 150 billion. Skatteetaten's estimates are probably rather excessive.

In a later email correspondence, the Subject wrote that the topic had been discuss around the office with colleagues who work with large businesses. This revealed that the legislation for large companies was the biggest hurdle to surpass. Multinational companies can easily adapt to cross-border structures that lead to reduced taxation. All of which occur within the legislation (tax avoidance) and can not be targeted by Norwegian tax authorities. To solve this issue and collect a greater tax amount, the legislation requires amendment, and global solution must be established.

8.3 Types of corporate misconduct



Source: OECD Survey on Business Integrity and Corporate Governance (59 responses).

Types of corporate misconduct reported via internal company mechanisms (source: OECD, 2016). Fraud is unlikely to include tax fraud since tax has its own category. A possible explanation why fraud is the most common is the *Qui Tam* programs. The OECD report claims that the most uncommon offence, money-laundering, is due to already well-established channels.