

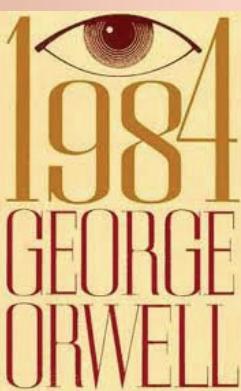
# The Policy Considerations Underlying Tax Secrecy and Tax Transparency

Yinon Tzubery, LL.M.

Research Associate DIBT (Doctoral Program in International Business Taxation)  
Institute for Austrian and International Tax Law  
VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS  
Althanstraße 39–45, 1090 Vienna, Austria

## I. Introduction

To file even a relatively modest income tax return a taxpayer must usually disclose to the tax authorities personal information that would normally remain private. The concept Tax Secrecy, or Tax Privacy as it is sometimes known, refers to measures in the tax legislation that restrict the tax administration from disclosing to any third party information it obtains during tax assessments it performs. The reversed regime is known as Tax Transparency. In this poster I explore the policy considerations underlying Tax Secrecy and Tax Transparency, in search for an appropriate equilibrium between these competing approaches.



**Figure 1.**  
*Big Brother is watching you.*  
George Orwell's '1984' dystopia about government's intrusion to personal privacy is claimed by some critics to materialize in present day tax discloser rules.

## II. Materials and methods

The analysis in this poster is based on an economic approach and avoids "rights discourse", since it presumes that justice and utilization are the same. The offered balance between the competing policy considerations is therefore the path that is expected to bring forward the maximum wealth measured in human satisfaction, taking into consideration the accumulated utilitarian effects.



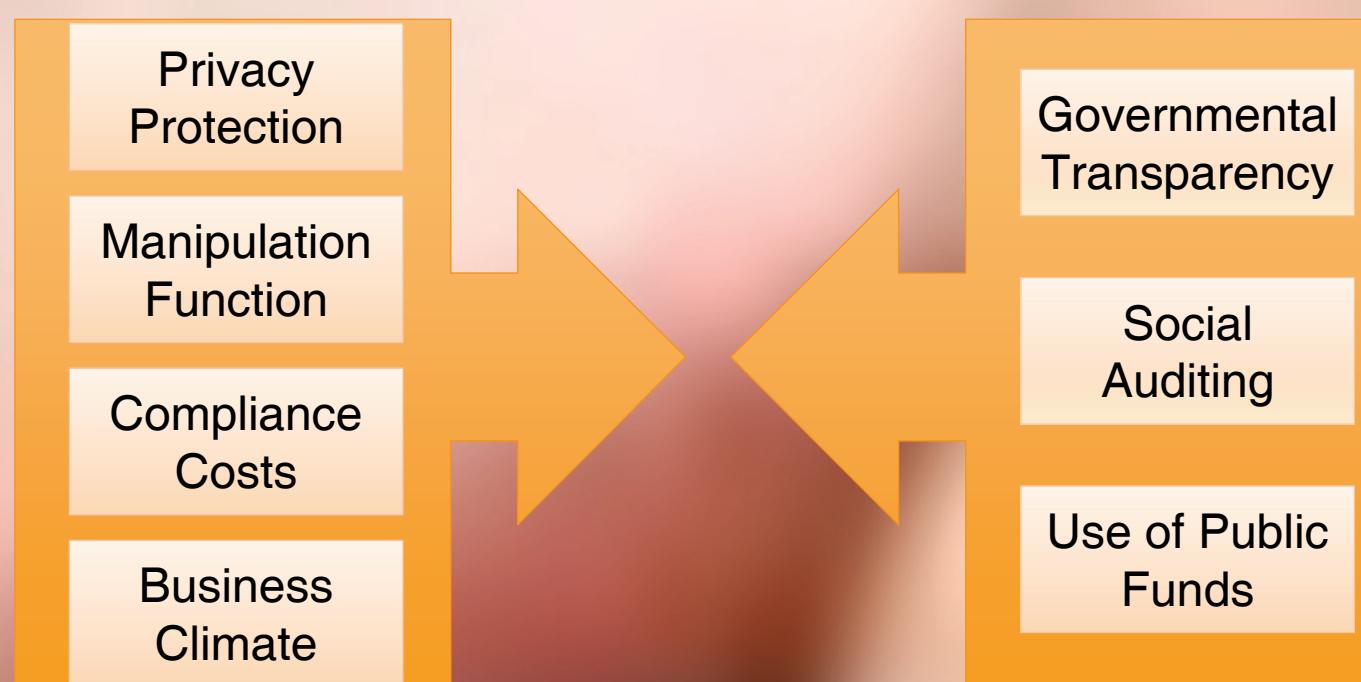
**Figure 2.**  
John Stuart Mill.

Utilitarianism is an ethic theory which was developed by Jeremy Bentham and John Stuart Mill. It holds that the proper course of action is the one that maximizes the overall "happiness", measured in amount of goods and number of people ("the greatest happiness principle").

## III. Analysis

### a) Policy considerations in support of tax secrecy:

1. *Privacy Protection.* The free flow of information increases competition for the benefit of the public. Privacy, in the form of information concealment, should therefore be protected only when its social benefits overcome the losses it causes. Many of the traditional arguments in support of privacy protection for tax information, such as harassment prevention, protection against irrational reactions to the information, and the inducement of genuine tax reporting by taxpayers, should be rejected after further consideration. Innovation support, on the other hand, can justify privacy protection for tax information, to the extent that it may reveal the innovation.



**Figure 3.** The policy considerations underlying tax secrecy (left) and tax transparency (right).

2. *The Manipulation Function of Tax Secrecy.* Tax secrecy filters the examples of tax enforcement acts that taxpayers see. It therefore enables the government to manipulate the taxpayers' perceptions of its tax enforcement capabilities by publishing salient examples of its tax enforcement success. The manipulation function is claimed to strengthen voluntary tax compliance. Despite its appealing traits this argument must be rejected as a consideration in support of tax secrecy. It offers to accept dishonest behavior by the government, which may prove to be a slippery slope.

3. *Business Climate.* Tax information disclosure will drive businesses and wealthy individuals away from a country which implements it. In an era of tax competition this consideration is important.

4. *Compliance Costs.* If taxpayers are to be burdened with tax disclosure requirements their compliance costs should be taken into account. Nevertheless, as compliance with tax transparency regime would require only the use of existing information, it is doubtful that such costs are meaningful.



**Figure 4.** Privacy Protection.

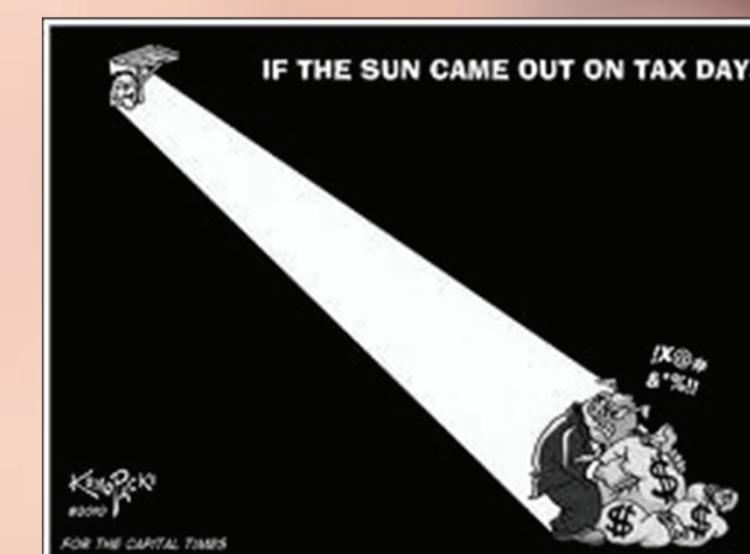
Many of the arguments which are traditionally raised in support of privacy protection of information can be questioned.

### b) Policy considerations in support of tax transparency:

1. *Governmental Transparency.* Government openness to the public gaze has an important function in democracy. It promotes public debate, secures administrations accountability and promotes tax moral. It therefore increases governance quality. Tax secrecy directly contradict with the public right to know.

2. *Social Auditing.* Public approach to tax returns information is expected to enable individuals to inform the authorities about evading taxpayers or suspiciously low tax payments. It may also promote public shaming of non-compliance. Transparency will therefore strengthen tax enforcement and increase tax compliance.

3. *Use of Public Funds.* Public scrutiny is in place when use of public funds is being made. For that reason, publicly traded companies are perceived as having less right for privacy. Transparency can also be supported with regard to taxpayers who enjoy tax expenditures, involved in tax evasion or do not pay their tax debts in due time.



**Figure 5.** Social auditing.

Crime thrives in the dark. Publicity would cast millions of eyes on tax information, promoting deterrence against tax avoidance and tax evasion.

## IV. Conclusions

- The policy considerations analysis shows that the case for tax transparency is strong. It is expected to increase markets efficiency, promote good governance and improve tax enforcement. Tax secrecy, on the other hand, seems to be justified only to the extent that it enables taxpayers to exploit their innovativeness.
- Privacy protection restricted to tax information that might reveal innovation, rather than comprehensive tax secrecy, seems to offer a balanced approach.
- The negative results of tax competition should be dealt with via coordination, e.g. in the ambit of the European Union.

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For exchange of ideas and further information please contact me via the E-mail [yinon.tzubery@wu.ac.at](mailto:yinon.tzubery@wu.ac.at), Telephone no. +43-1-313 36-5931 or Fax no. +43-1-313 36-730. More information on this and related projects can be obtained at [www.wu.ac.at/taxlaw](http://www.wu.ac.at/taxlaw).