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The Fraud Triangle and Tax Evasion

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*Leandra Lederman**

ABSTRACT

The “fraud triangle” is the preeminent framework for analyzing fraud in the accounting literature. It is a theory of why some people commit fraud, developed out of studies of individuals, including inmates convicted of criminal trust violations. The three components of the fraud triangle are generally considered to be (1) an incentive or pressure (usually financial), (2) opportunity, and (3) rationalization.

There is a separate, extensive legal literature on tax compliance and evasion. Yet the fraud triangle is largely absent from this legal literature, although tax evasion is a type of fraud. This article rectifies that oversight, analyzing how the fraud triangle—and its expanded version, the “fraud diamond”—can inform the legal literature on tax compliance. The article argues that the fraud triangle can provide a frame that brings together distinct tax compliance theories discussed in the legal literature, the traditional economic (deterrence) model and behavioral theories focusing on such things as social norms or tax morale.

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INTRODUCTION

Because any system of taxation faces the prospect of evasion,¹ the question of how to increase compliance with applicable tax laws is an important one for governments worldwide. There is an extensive set of literatures on this issue spanning multiple fields, including both law and economics. The traditional economic model considers tax evasion a type of gamble.² The legal literature frequently references that model and analyzes deterrence.³ In recent years, economics and legal scholarship have moved beyond deterrence, and have considered behavioral explanations for compliance such as social norms of compliance⁴ or “tax morale”—the intrinsic

¹ See Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERS. 25, 25 (2007) (“[E]ven in the face of . . . penalties, substantial tax evasion exists—and always has. The history of taxation is replete with episodes of evasion, often notable for their inventiveness.”).

² See Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323, 324 (1972) (“The tax declaration decision is a decision under uncertainty. The reason for this is that failure to report one’s full income to the tax authorities does not automatically provoke a reaction in the form of a penalty. The taxpayer has the choice between two main strategies: (1) He may declare his actual income. (2) He may declare less than his actual income.”).

³ For recent examples, see, e.g., Kathleen Delaney Thomas, *The Psychic Cost of Tax Evasion*, 56 BOSTON COLL. L. REV. 617, 622 (2015) (“Standard deterrence theory, as applied to tax compliance, assumes that taxpayers are rational actors seeking to maximize their expected utility.”); Leandra Lederman, *Does Enforcement Reduce Voluntary Tax Compliance?*, 2018 B.Y.U. L. REV. 627, 647-55 (discussing the deterrence model); Adam Thimmesch, *Testing the Models of Tax Compliance: The Use-Tax Experiment*, 2015 UTAH L. REV. 1083, 1084 (“Traditional economic or deterrence theories assert that the decision to comply depends on a cost-benefit or expected-utility analysis.”).

⁴ See, e.g., Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner’s LAW AND SOCIAL NORMS*, 36 U. RICH. L. REV. 367, 380 (2002) (“The reciprocity theory not only furnishes a convincing explanation for the phenomenon of tax evasion; it also suggests a novel theory for combating it: the promotion of trust.”); Lederman, *supra* note 3, at 658 (“[S]everal field studies have shown that appealing to compliance norms may have a positive effect. In fact, norms-based appeals may bolster enforcement efforts.”) (footnotes omitted); Thimmesch, *supra* note 3, at 1095 (“One significant nonpecuniary model of tax compliance suggests a social-norm rationale for tax-compliance decisions.”).

motivation to comply.⁵ The tax compliance literature, particularly the economics literature, also includes numerous experiments, both in the laboratory and with actual taxpayers.⁶

There is also a separate accounting literature on fraud. A central concept in the accounting literature is the fraud triangle, which has been called “[t]he dominant framework relating to fraud . . . , embedded in professional auditing standards around the world . . . including the USA . . . , Australia . . . and international audit standards”⁷ The fraud triangle is a theory of why people commit fraud.⁸ The “triangle” aspect of the fraud triangle reflects the fact that the theory contains three factors.⁹ The fraud triangle has been applied to a range of malfeasance, including student plagiarism; the Volkswagen emissions scandal; and Bernie Madoff’s Ponzi scheme.¹⁰ In addition, a widely-cited article proposed adding a fourth factor—an individual’s capability to carry out the fraud—dubbing the updated theory the “fraud diamond.”¹¹

⁵ See, e.g., Lars P. Feld & Bruno S. Frey, *Trust Breeds Trust: How Taxpayers Are Treated*, 3 ECON. GOVERNANCE 87, 88 (2002) (“[T]he existence of an intrinsic motivation to pay taxes . . . has sometimes been called ‘tax morale.’”); Bruno S. Frey, *Deterrence and Tax Morale in the European Union*, 11 EUR. REV. 385, 388-89 (2003) (seeking to “demonstrate that intrinsic motivation in the form of ‘tax morale’ is of substantial importance in explaining tax paying behavior.”); Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599, 602-03 (2007) (“The key to the [tax compliance] puzzle is ‘tax morale,’ the collective name for all the non-rational factors and motivations—such as social norms, personal values and various cognitive processes—that strongly affect an individual’s voluntary compliance with laws.”); cf. Lederman, *supra* note 3, at 627 (“While there is certainly room for civic commitments and respect for the law as explanations for some compliance, the lack of opportunity for tax evasion—which Frey does not analyze as a possible explanation—explains much tax compliance and is consistent with the deterrence model.”).

⁶ See Giulia Mascagni, *From the Lab to the Field: A Review of Tax Experiments*, 32 J. ECON. SURV. 273, 274 (2017) (“A recent surge in empirical studies has contributed to shed more light on the role of these factors in determining tax compliance and on what tax administrators can do to improve it. This recent surge has seen the emergence of large-scale field experiments, that are arguably more rigorous and policy relevant than previous studies.”).

⁷ Clinton Free, *Looking Through the Fraud Triangle: A Review and Call for New Directions*, 23 MEDITIARI ACCOUNTANCY RES. 175, 177 (2015) (citations omitted).

⁸ See *infra* Part I.A.

⁹ See *infra* text accompanying note 13.

¹⁰ See, e.g., Kenneth H. Ryesky, *Part Time Soldiers: Deploying Adjunct Faculty in the War Against Student Plagiarism*, 2007 BYU EDUC. & L.J. 119, 144-145 (2007) (student plagiarism); Walter Pavlo, *Bernard Madoff Is the Fraud Triangle*, FORBES (Mar. 1, 2011, 9:28 AM), <https://www.forbes.com/sites/walterpavlo/2011/03/01/bernard-madoff-is-the-fraud-triangle/#59ea2f346cad> (Bernie Madoff); see also W. Steve Albrecht, *Iconic Fraud Triangle Endures*, FRAUD MAGAZINE, July-Aug. 2014, at 7 (citing such examples as student cheating, speeding while driving, and cheating on one’s spouse, and referring to a more encompassing “Compromise Triangle”); Mandy Moody, *Placing Volkswagen Into the Fraud Triangle*, ASS’N OF CERTIFIED FRAUD EXAMINERS NEWS (June 14, 2016) <https://www.fraudconferencenews.com/home/2016/6/14/placing-volkswagen-into-the-fraud-triangle> (applying the fraud triangle to the Volkswagen emissions scandal); Homer B. Warren et. al., *The Likelihood of Deception in Marketing: A Criminological Contextualization*, 31 BUS. & PROF. ETHICS J. 109 (2012) (applying the fraud triangle to deceptive marketing practices).

¹¹ David T. Wolfe & Dana R. Hermanson, *The Fraud Diamond: Considering the Four Elements of Fraud*, 74 CPA J.38, 38 (Dec. 2004).

Despite the preeminent role the fraud triangle theory plays within the accounting literature on fraud, it is almost entirely absent from the extensive legal literature on tax compliance and evasion.¹² This Article fills the gap. Part I describes the current version of the fraud triangle, then discusses the fascinating evolution of the fraud triangle. It also analyzes two additional elements that may contribute to fraud.

Part III of the Article applies the fraud triangle and fraud diamond to tax evasion, exploring how each of the three fraud triangle factors plus the fourth factor, “capability,” apply to tax evasion. Part IV then applies the fraud triangle frame to leading theories of tax compliance, arguing that it helps bridge the major competing approaches to tax enforcement: deterrence and behavioral approaches. The Article concludes that the fraud triangle is a powerful tool with which to conceptualize tax evasion, and it helps provide a framework that both supports the deterrence model and allows other factors to coexist with deterrence.

I. THE FRAUD TRIANGLE

The fraud triangle is a three-pronged theory of why some individuals commit occupational fraud. The three factors have evolved somewhat over the years, as discussed below.¹³ However, the current fraud triangle factors are generally understood to be those described in American Institute of Certified Public Accountants (AICPA) and international auditing standards: “[f]raud, whether fraudulent financial reporting or misappropriation of assets, involves *incentive or pressure* to commit fraud, a *perceived opportunity* to do so, and some *rationalization* of the act”¹⁴ These standards were adopted in the early 2000s by the AICPA in what was then called SAS No. 99¹⁵ and by the International Auditing and Assurance Standards Board in ISA 240.¹⁶ Although these standards do not specifically use the phrase “fraud triangle,” they are understood to refer to it.¹⁷

¹² See *infra* notes 230-234 and accompanying text.

¹³ See *infra* Part I.B.3.

¹⁴ AICPA, *AU-C Section 240, Consideration of Fraud in a Financial Statement Audit*, AU-C §240.A1, <https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00240.pdf>; International Standard on Auditing 240, *The Auditor’s Responsibilities Relating To Fraud In An Audit Of Financial Statements*, A1, <http://www.ifac.org/system/files/downloads/a012-2010-iaasb-handbook-isa-240.pdf> (hereinafter, ISA 240).

¹⁵ SAS No. 99, *supra* note 183. SAS No. 99 was subsequently incorporated into AU sec. 316. ASS’N OF INT’L CERTIFIED PUB. ACCOUNTANTS, STATEMENTS ON AUDITING STANDARDS. See <https://www.aicpa.org/research/standards/auditattest/sas.html> (last visited Feb. 11, 2019). AU sec. 316 has since been superseded by AU-C sec. 240. See ASS’N OF INT’L CERTIFIED PUB. ACCOUNTANTS, AU-C EXHIBIT A, <https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-exhibita.pdf>.

¹⁶ International Federation of Accountants, *Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements*, <https://www.iaasb.org/projects/auditors-responsibility-consider-fraud-audit-financial-statements> (discussing revisions to ISA 240).

¹⁷ See, e.g., Albrecht, *supra* note 10, at 6 (“[I]n 2002, the Auditing Standards Board of the American Institute of Certified Public Accountants used the Fraud Triangle as a critical element of ‘SAS 99: Consideration of Fraud.’”); Free, *supra* note 7, at 17 (“The dominant framework relating to fraud is the so-called “fraud triangle” . . . , which is embedded in professional auditing standards around the world . . . including the USA (SAS No. 99), Australia (ASA 240) and international audit standards (ISA 240).”

With respect to the first prong, “incentive or pressure,” ISA 240 and the currently applicable AICPA standard describe it as generally financial.¹⁸ The statement regarding “perceived opportunity” for fraud is brief and points to an individual’s ability to override internal controls.¹⁹ The AICPA and ISA describe the “rationalization” prong as relating either to personal characteristics of the individual or resulting from a pressure-filled environment:

Individuals may be able to rationalize committing a fraudulent act. *Some individuals possess an attitude, character, or set of ethical values* that allow them knowingly and intentionally to commit a dishonest act. However, *even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.*²⁰

In these auditing standards, the fraud triangle’s three elements are also used to help organize “risk factors” for fraud.²¹ For example, with respect to “Risk Factors Relating to Misstatements Arising From Fraudulent Financial Reporting” both ISA 240²² and the AICPA standard lists under “Incentives/Pressures” four items, including “[f]inancial stability or profitability is threatened by economic, industry, or entity operating conditions,” with most of the items followed by a bulleted list containing more specifics.²³ The “opportunities” prong is

(citations omitted)); Wolfe & Hermanson, *supra* note 11, at 38 (“This three-pronged framework, commonly known as the ‘fraud triangle,’ has . . . been formally adopted by the auditing profession as part of SAS 99.”).

¹⁸ See AICPA, *supra* note 14, at § 240.A1; ISA 240, *supra* note 14, at A1. The language generally is identical. The International Auditing Practices Committee (IAPC) and U.S. Auditing Standards Board (ASB) apparently worked closely together. The International Federation of Accountants reports the history as follows:

In March 2001, the IAPC issued ISA 240. In March 2001, the US ASB invited representatives of the IAPC to attend meetings of the US ASB’s Fraud Task Force. The IAPC accepted the invitation with the view to obtaining an understanding of the development of a revised US SAS 82 so that ISA 240 could be revised to converge with the final revised US SAS 82, subject to any differences necessary to take account of the international environment.

In February 2002, the US ASB issued an exposure draft Consideration of Fraud in a Financial Statement Audit. The IAASB issued a response letter to this exposure draft.

In October 2002, the US ASB issued SAS 99.

Internat’l Fed. of Accountants, *Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements*, <https://www.iaasb.org/projects/auditors-responsibility-consider-fraud-audit-financial-statements>.

¹⁹ AICPA, *supra* note 14, at § 240.A1 (“A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden (for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control).”); ISA 240, *supra* note 14, at A1 (same).

²⁰ AICPA, *supra* note 14, at § 240.A1 (emphasis added); ISA 240, *supra* note 14, at A1 (emphasis added).

²¹ See AICPA, *supra* note 14, at App. 1.

²² See ISA 240, *supra* note 14, at App. 1.

²³ See AICPA, *supra* note 14, at App. A. The ISA approach is the same; for convenience, only the AICPA standard is cited here.

similarly organized.²⁴ The final factor is termed “Attitudes/Rationalizations,” and contains twelve main bullet points.²⁵

Several scholars have conducted empirical studies designed to test the AICPA’s three factors as predictors of fraud.²⁶ They developed proxies for various factors that fit under each prong.²⁷ They generally found statistically significant results for some proxies for pressure and opportunity, but some studies did not find statistically significant results for rationalization variables.²⁸ Skousen et al. note that rationalization is the most difficult of the three factors to measure.²⁹ The studies generally found their models successful in identifying “fraud” and “no-fraud” items in their data sets.³⁰ Skousen et al. stated that their “results represent a substantial improvement over other fraud prediction models”³¹ Lokanan and Sharma argued that the fraud triangle, although not a scientific method, is a useful tool:

White-collar criminologists will tell you that there is no single theory or framework that can explain every occurrence of fraud In the same manner, the fraud triangle was not intended to be a “cure for every ill” Rather, the fraud triangle should be used as a framework to understand the basic motivations, opportunities, and rationalizations for fraud. . . . Underlying this position is the notion that the fraud triangle offers flexibility and adaptability and can be operationalized in a different context to guide fraud inquiries.³²

²⁴ *Id.*

²⁵ *Id.*

²⁶ See, e.g., Mark Lokanan & Satish Sharma, *A Fraud Triangle Analysis of the Libor Fraud*, 10 J. OF FORENSIC & INVESTIGATIVE ACCT. 187 (2018) (applying the factors to the Libor scandal); Dianne M. Roden et al., *The Fraud Triangle as a Predictor of Corporate Fraud*, 20 ACAD. OF ACC’TING & FIN. STUD. J. 80 (Jan. 2016); Yung-I Lou et al., *Fraud Risk Factor of the Fraud Triangle Assessing The Likelihood of Fraudulent Financial Reporting*, 7 J. BUS. & ECON. RES. 61 (Feb. 2009); Christopher J. Skousen, et al., *Detecting And Predicting Financial Statement Fraud: The Effectiveness Of the Fraud Triangle and SAS No. 99*, in MARK HIRSCHHEY, ET AL. (eds.) CORPORATE GOVERNANCE AND FIRM PERFORMANCE (ADVANCES IN FIN. ECON., vol. 13) 53 (2009).

²⁷ See Lokanan & Sharma, *supra* note 26, at 192-95; Roden et al., *supra* note 26, at 85-86; Skousen et al., *supra* note 26, at 59; Lou et al., *supra* note 26, at 62.

²⁸ See Lokanan & Sharma, *supra* note 26, at 198; Lou et al., *supra* note 26, at 68 tbl. 2; Skousen et al., *supra* note 26, at 70. Roden et al. found statistically significant results for two proxies for rationalization (at $p < .05$). Roden et al., *supra* note 26, at 89 tbl. 3. Lou et al. found statistically significant results (at $p < .01$) for variables for “attitude/rationalization.” Lou et al., *supra* note 26, at 69.

²⁹ Skousen et al., *supra* note 26, at 66.

³⁰ See Lokanan & Sharma, *supra* note 26, at 198 (“Overall, the model predicts the values correctly around seventy-percent of the time, which is a pretty good fit.”); Lou et al., *supra* note 26, at 68 tbl. 2 (Rate of correct classification in the present model is 86.5%, higher than models developed by . . . [certain other scholars].”) (citations omitted); Skousen et al., *supra* note 26, at 79 (“Overall, the models correctly classify firms between 70 and 73 percent of the time These results represent a substantial improvement over other fraud prediction models that have success rates of 30 to 40 percent.”). *But cf.* Roden et al. (not addressing this issue).

³¹ Skousen et al., *supra* note 26, at 79 (citations omitted).

³² Lokanan & Sharma, *supra* note 26, at 189 (citations omitted).

A. *The Fraud Triangle's Embezzlement Origins*

Donald Cressey's work in the early 1950s is typically cited as the origin of the fraud triangle.³³ He developed three factors to explain why some individuals employed in positions of trust embezzle, while others do not.³⁴ His three factors were (1) a non-shareable pressure (generally financial), (2) a perceived opportunity to embezzle, and (3) rationalization of the planned violation.³⁵

Edwin Sutherland's work is sometimes cited as the antecedent of Sutherland's study.³⁶ Sutherland, who spent the last 15 years of his career as a professor at Indiana University (IU),³⁷ coined the term "white-collar criminal" in a 1939 speech to the American Sociological Association.³⁸ Donald Cressey was one of Sutherland's Ph.D. students at IU.³⁹

Sutherland was seeking to overcome a common understanding of crime as committed overwhelmingly by members of the "lower class"⁴⁰ and thus "caused by poverty or by personal and social characteristics believed to be associated statistically with poverty"⁴¹ He argued

³³ See, e.g., Rasha Kassem & Andrew Higson, *The New Fraud Triangle Model*, J. EMERG. TRENDS IN ECON. & MGMT SCI. 191, 193 (2012) ("Cressey's fraud theory, normally known as the fraud triangle theory, was widely supported and used by audit professionals and standards' setters as a tool for detecting fraud."); Alexander Schuchter & Michael Levi, *The Fraud Triangle Revisited*, 29 SECURITY J. 107, 107 (2016) ("This article revisits the Fraud Triangle, an explanatory framework for financial fraud, developed by the American criminologist Donald Cressey.").

³⁴ See DONALD R. CRESSEY, *OTHER PEOPLE'S MONEY: A STUDY IN THE SOCIAL PSYCHOLOGY OF EMBEZZLEMENT* 12 (1953).

³⁵ *Id.* at 30.

³⁶ See, e.g., Albrecht, *supra* note 10, at 1 ("Two individuals who probably deserve the most credit for the fraud [triangle] model are early criminology researchers Edwin Sutherland and Donald Cressey."); Jack W. Dorminey et al., *Beyond the Fraud Triangle: Enhancing Deterrence of Economic Crimes*, 80 THE CPA J. 17, 18 (2010) ("The concept of a fraud triangle dates back to the work of Edwin Sutherland, who coined the term white-collar crime, and Donald Cressey who wrote *Other People's Money*").

³⁷ NEW WORLD ENCYCLOPEDIA, *Edwin Sutherland*, http://www.newworldencyclopedia.org/entry/Edwin_Sutherland.

³⁸ Jérémy Morales et al., *The Construction of The Risky Individual and Vigilant Organization: A Genealogy of the Fraud Triangle*, 39 ACCOUNTING, ORG. & SOC. 170, 173 (2014); see Edwin H. Sutherland, *Annual Presidential Address to the American Sociological Association and the American Economic Society: White-Collar Criminality* (Dec. 27, 1939), reprinted in 5 AM. SOC. REV. 1 (1940).

³⁹ Albrecht, *supra* note 10, at 1; see also Morales et al., *supra* note 38, at 176 (citing JOSEPH T. WELLS, *OCCUPATIONAL FRAUD AND ABUSE: HOW TO PREVENT AND DETECT ASSET MISAPPROPRIATION, CORRUPTION AND FRAUDULENT STATEMENTS* (1997)). Cressey also co-authored with Sutherland. Albrecht, *supra* note 10, at 1.

⁴⁰ Sutherland, *supra* note 38, at 1 ("The criminal statistics show unequivocally that crime, as popularly conceived and officially measured, has a high incidence in the lower class and a low incidence in the upper class; less than two percent of the persons committed to prisons in a year belong to the upper class.").

⁴¹ *Id.*; see also Morales et al., *supra* note 38, at 173 ("Sutherland (1983) showed that criminology greatly underestimated (or even obscured) the violations of law perpetrated by persons of the upper socioeconomic class.").

for a theory of crime that explained “both white-collar criminality and lower class criminality.”⁴² Thus, for Sutherland, the term “white collar” focused on the socio-economic status of the offender, rather than focusing on the nature of the offense. In his 1949 book, Sutherland stated that “[w]hite collar crime may be defined approximately as a crime committed by a person of respectability and high status in the course of his occupation.”⁴³

Sutherland advanced the theory that criminality was learned behavior, rather than due to personal characteristics. He called the process “differential association” because he argued that criminality depends on the frequency with which the person associates with criminal or non-criminal behavior⁴⁴—an argument that today would likely refer to the norms of the individual’s community or workplace.⁴⁵

1. Donald Cressey’s Work on Embezzlement

Donald Cressey argued that “Sutherland’s position was confused by the fact that he studied corporations, rather than individual white-collar criminals.”⁴⁶ Cressey focused his doctoral research on embezzlers for that reason.⁴⁷ He stated, “It was my impression that embezzlers are white-collar criminals whose backgrounds are not likely to contain the social and personal pathologies which popular notions and traditional theory ascribe to criminals.”⁴⁸

⁴² Sutherland, *supra* note 38, at 10.

⁴³ EDWIN H. SUTHERLAND, *WHITE COLLAR CRIME* 9 (1949). He added further detail in a footnote, specifically excluding from the term “most of their cases of murder, adultery and intoxication” and “confidence games of wealthy members of the underworld, since they are not persons of high respectability and social status.” *Id.*

The same year, Sutherland defined “white-collar criminal” in *The Encyclopedia of Criminology* as “a person with high socio-economic status who violates the laws designed to regulate his occupational activities.” Edwin H. Sutherland, *The White-Collar Criminal* in V.C. BRANHAM & S.B. KUTASH, *ENCYCLOPEDIA OF CRIM.* 511 (1949).

⁴⁴ Sutherland’s specific argument was as follows:

[W]hite-collar criminality, just as other systematic criminality, is learned; that it is learned in direct or indirect association with those who already practice the behavior; and that those who learn this criminal behavior are segregated from frequent and intimate contacts with law-abiding behavior. Whether a person becomes a criminal or not is determined largely by the comparative frequency and intimacy of his contacts with the two types of behavior. This may be called the process of differential association.

SUTHERLAND, *supra* note 43, at 10-11.

⁴⁵ Cf. Cheryl Lero Jonson & Gilbert Geis, *Cressey, Donald R.: Embezzlement and White-Collar Crime*, *ENCYCLOPEDIA OF CRIM. THEORY* 228 (2010) (“Cressey especially applied Sutherland’s differential association theory to the analysis and control of management fraud He argued that management fraud could be explained through an understanding that people are exposed to definitions both favorable and unfavorable to the violation of law.”) (citations omitted).

⁴⁶ Donald R. Cressey, *The Respectable Criminal*, 3 *CRIMINOLOGICA* 13, 13 (1965).

⁴⁷ WELLS, *supra* note 39, at 10. While a sociology graduate student at Indiana University, Cressey took a course from Jerome Hall at the Law School, which was very unusual at the time. Donald R. Cressey, *Jerome Hall and Sociological Criminology*, 32 *HASTINGS L.J.* 1384 (Jul. 1981).

⁴⁸ Cressey, *supra* note 46, at 13.

Cressey noted that the trust-violation crimes he studied did not all constitute “white-collar crime” as defined by Sutherland:

In his doctoral research, which became a book, Cressey's "objective [was] to separate, on the basis of a causal process, the behavior of trusted persons who violate their trust from the behavior of non-violators."⁴⁹ In other words, he sought an explanation for why "*some persons in positions of financial trust violate their trust*, whereas other persons, or even the same person at a different time, in identical or very similar positions do not violate it."⁵⁰

Cressey conducted interviews with the inmates in three penitentiaries (one each in California, Illinois, and Indiana⁵¹) who, after apparently accepting a position of trust in good faith, had been convicted of embezzlement or a similar crime.⁵² Cressey's sample included a total of 133 male individuals.⁵³ Because Cressey was not interested in the career criminal or people who had accepted a position of trust planning to embezzle, he excluded from his sample numerous inmates who did not accept the position of trust in good faith.⁵⁴

The method Cressey used was analytic induction, which "involves a researcher beginning with a set of postulates and then continually readjusting them so that they encompass all evidence that the data produce. Thus, if a negative case is found, the hypothesis is reformulated until all cases support the generalization."⁵⁵ Cressey states that his "formulation of hypotheses

As a class of crimes, trust violation cannot be considered a "white collar crime."

Sutherland has defined that type of crime as violations of law by persons of respectability and high social status in the course of their occupations. . . . While the crimes of trust violation are committed in the course of their occupations, many of the violators cannot be considered as persons of high social status or as respected persons of the community.

Id. at 184 n.9 (citing SUTHERLAND, *supra* note 43).

⁴⁹ Donald R. Cressey, *Why Do Trusted Persons Commit Fraud?: A Social-Psychological Study of Defalcators*, 92 J. ACCOUNTANCY 577 (1951). Nettler reports that it was the "moral denigration of the embezzler that piqued Cressey and against which his hypothesis has been advanced." Gwynn Nettler, *Embezzlement Without Problems*, 14 BRITISH J. OF CRIM. 70, 72 (1974).

⁵⁰ CRESSEY, *supra* note 34, at 12 (emphasis added).

⁵¹ *Id.* at 22-23. The interviews were conducted in 1949 to 1951. *Id.* Cressey's sample included both state and federal prisoners. *See* Cressey, *supra* note 48, at 14 ("I was disturbed because my sample of embezzlers included very few bankers; this was because embezzlement is a federal offense and most of my interviews had been conducted in state prisons. So I spent a summer working in the United States Penitentiary in Terre Haute, Indiana.").

⁵² Cressey, *supra* note 49, at 578. Due to differences in legal definitions, Cressey's criteria for inclusion did not require that the crime constitute "embezzlement" under state law. Instead, the study focused on inmates who had "accepted a position of trust in good faith" and later "violated that trust by committing a crime." CRESSEY, *supra* note 34, at 20.

⁵³ CRESSEY, *supra* note 34, at 25 ("The 73 inmates at Joliet, [Illinois;] the 21 at Chino [, California;] and the 39 at Terre Haute[, Indiana] whose cases met the criteria were interviewed frequently and at length."). Thus, Cressey's subjects, unlike Svend Riemer's were not specifically selected on the basis as having raised or been considered for an insanity defense. *See infra* text accompanying notes 143-144 (discussing Riemer's case selection).

⁵⁴ *See* CRESSEY, *supra* note 34, at 23 (stating that he screened 503 inmates and "as expected, many cases did not meet the first criterion—acceptance of a position of trust in good faith").

⁵⁵ Jonson & Geis, *supra* note 45, at 225. Cressey described his methodology as follows: First, a rough definition of the phenomenon to be explained is formulated. Second, an [sic] hypothetical explanation of that phenomenon is formulated. Third, one case is

was guided entirely by the search for negative cases” to disprove the hypothesis.⁵⁶ Using this methodology, Cressey rejected several hypotheses as not fitting all of the inmates he interviewed.⁵⁷ Ultimately, he phrased his summary as follows:

“Trusted persons become trust violators when; (1) they conceive of themselves as having a financial problem which is non-shareable; (2) have the knowledge or awareness that this problem can be secretly resolved by violation of the position of financial trust; and (3) are able to apply to their own conduct in that situation a verbalization which enables them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users of the entrusted funds or property.” Unless there is movement through this sequence, a trusted person does not become a violator.⁵⁸

Thus, Cressey found three factors common to individuals who became embezzlers or similar trust violators.⁵⁹ His first factor, a *non-shareable financial pressure*, could involve something embarrassing to the individual, such as a gambling debt⁶⁰ or failure of one’s business.⁶¹ Cressey considered non-shareability—the subjective inability to tell intimates, such

audited in light of the hypothesis with the objective of determining whether the hypothesis fits the facts in that case. Fourth, if the hypothesis does not fit the facts, either the hypothesis is re-formulated or the phenomenon to be explained is re-defined, so that the case is excluded. This definition must be more precise than the first one. Fifth, practical certainty may be attained after a small number of cases has been examined, but the discovery by the investigator or any other investigator of a single negative case disproves the explanation and requires a re-formulation. Sixth, this procedure . . . is continued until a universal relationship is established Seventh, for purposes of proof, cases outside the area circumscribed by definition are examined to determine whether or not the final hypothesis applies to them.

CRESSEY, *supra* note 34, at 16.

⁵⁶ CRESSEY, *supra* note 34, at 17.

⁵⁷ CRESSEY, *supra* note 49, at 578.

⁵⁸ *Id.* at 577-78. “Thirty years after his original research, Cressey concluded that while the unshareable problem was important, it was ‘not critical,’ and it was the neutralization of the criminal nature of the behavior that was his most salient finding.” Gary S. Green, *White-Collar Crime and the Study of Embezzlement*, 525 THE ANNALS OF THE AM. ACAD. OF POLIT. & SOC. SCI. 95, 102 (1993).

⁵⁹ Cressey found that all three factors he identified as common to the cases were necessary for the crime to occur. *Id.* at 31 (“The entire process must be present.”).

⁶⁰ CRESSEY, *supra* note 49, at 578.

⁶¹ *Id.* at 579-80.

as the individual's wife⁶²—critical to embezzlement.⁶³ Of Cressey's three factors, this one has undergone the most change over the years, as discussed below.

Cressey's second factor generally involves the *perceived opportunity* to commit the trust violation.⁶⁴ Cressey argued that opportunity involved not just holding the position of trust but also perceiving that the opportunity to convert entrusted funds for one's own use.⁶⁵ The trust violator may also use technical skills to identify the opportunity.⁶⁶ For example, in Cressey's Case 47, an accountant stated:

I learned all of it in school and in my ordinary accounting experience. In school they teach you in your advanced years how to detect embezzlements, and you sort of absorb it . . . I did not use any techniques which any ordinary accountant in my position could not have used⁶⁷

The third Cressey factor is *rationalization* of the behavior as somehow acceptable⁶⁸—a mental verbalization of the planned act as somehow not criminal.⁶⁹ Cressey stated that the rationalizing thought process of the eventual trust violator occurred *before* the trust violation,

⁶² See CRESSEY, *supra* note 34, at 28 (“The specific hypothesis here was unknowingly suggested by a prisoner who stated that he believed that no embezzlement would occur if the trusted person always told his wife and family about his financial problems, no matter what the consequences.”); Donald R. Cressey, *The Criminal Violation of Financial Trust*, 15 AM. SOC. REV. 738, 742 n.13 (1951) (“None of the[trust violators], of course, used the words ‘non-shareable problem,’ but many of them stated that they were ‘ashamed’ to tell anyone of a certain situation or that they had ‘too much false pride’ to get help from others.”).

⁶³ See CRESSEY, *supra* note 34, at 34, 75; Cressey, *supra* note 48, at 15 (“Wherever a company program solves a financial problem, or makes it shareable, embezzlement will not occur.”).

At least one of the cases Cressey considered seems to undermine this factor. Cressey quotes Case 237, which was “[f]rom the files of a District Attorney's Office”, as involving a banker whose “wife needed some medical attention of an unethical nature, and through a friend he got in touch with a doctor in X” who later demanded money from him. CRESSEY, *supra* note 34, at 71. In this case, the embezzler's wife was aware of at least the source of the financial pressure—the “unethical” medical service. *Cf. id.* at 50 (quoting Case 99 as stating “My wife only knew about it when I got about \$3,000 short.”).

⁶⁴ See CRESSEY, *supra* note 34, at 77 (heading Chapter 3 “Identification of the Opportunity for Trust Violation”).

⁶⁵ *Id.* at 77.

In 2014, Steve Albrecht stated that “In my early research and after interviewing and studying many additional perpetrators, I added another development to the Fraud Triangle. I became convinced that neither the pressure nor the opportunity elements of the Fraud Triangle needed to be real but rather only perceived.” Albrecht, *supra* note 10, at 6. This is consistent with Cressey's analysis, which states that “trust violators . . . *conceive of themselves as* having a financial problem which is non-shareable,” CRESSEY, *supra* note 34, at 30 (emphasis added), and refers to the “perception . . . of the connection between the non-shareable problem and the illegal solution”, *id.* at 78.

⁶⁶ Albrecht, *supra* note 10, at 78-79, 85.

⁶⁷ CRESSEY, *supra* note 34, at 82.

⁶⁸ *Id.* at 93.

⁶⁹ Cressey, *supra* note 48, at 15.

allowing it to occur.⁷⁰ Cressey also argued that this process likely applies to “other types of respectable crime as well.”⁷¹ Rationalization serves the psychological purpose of minimizing the cognitive dissonance between thinking of oneself as honest and committing a dishonest act.⁷²

Cressey further argued that “[e]ach trusted person does not invent a new rationalization for his violation of trust, but instead he applies to his own situation a verbalization which has been made available to him by virtue of his having come into contact with a culture in which such verbalizations are present.”⁷³ This is reminiscent of Sutherland’s view that criminality is learned, rather than inherent.⁷⁴

In searching for negative cases, Cressey states that he examined the cases of the 133 men he interviewed, an additional approximately 200 case files “collected by Edwin Sutherland in the 1930s,”⁷⁵ and additional cases that Cressey found in the literature. He found that all cases he examined fit the three criteria or, if incomplete for his purposes, did not contain information

⁷⁰ CRESSEY, *supra* note 34, at 94 (“In the cases of trust violation encountered[,] significant rationalizations were always present *before* the criminal act took place, or at least at the time it took place, and, in fact, after the act had taken place[,] the rationalization often was abandoned.”).

⁷¹ Cressey, *supra* note 48, at 16. Cressey appears to be using the term “respectable crime” to refer to what we would today call “white-collar crime.” *See id.* at 13 (referring to “[t]ax evaders, along with people who pad their insurance claims, embezzle from their employers or conspire with others to fix the price of goods usually have steady jobs and wear white collars to work.”).

⁷² Sridhar Ramamoorti, *The Psychology and Sociology of Fraud: Integrating the Behavioral Sciences Component Into Fraud and Forensic Accounting Curricula*, 23 ISSUES IN ACC’TING EDUC. 521, 525 (2008).

⁷³ CRESSEY, *supra* note 34, at 137.

⁷⁴ *See supra* text accompanying note 44. Green explains:

Cressey initially attempted to ascertain whether differential association explained embezzlement. The effort was understandable because Sutherland, his mentor, had labeled embezzlement a ‘white-collar crime’ and had insisted that differential association was the most plausible explanation for all white-collar crime. While Cressey abandoned differential association early in his study as a root cause of embezzlement, he did report that his findings provided indirect support for the theory.

Green, *supra* note 58, at 103. *See also* Donald R. Cressey, *Application and Verification of the Differential Association Theory*, 43 J. OF CRIM. L., CRIMINOLOGY & POLICE SCI. 43, 51 (May-Jun., 1952) (“While the general contention of the differential association theory, that criminality is learned, cannot be disputed, the more specific idea that criminality and non-criminality depend upon a ratio of contacts with criminal and anti-criminal behavior patterns is open to question in cases of crimes involving violation of financial trust.”).

⁷⁵ CRESSEY, *supra* note 34, at 30. Few background details are provided about these cases. *See* Marshall B. Clinard, *Review of Other People’s Money: A Study in the Social Psychology of Embezzlement*, 19 AM. SOC. REV. 362 (Jun. 1954) (“Exactly how he used this [Sutherland] material and what information was available is not clear.”). Cressey does state in a footnote in his book that “Cases numbered 1 to 200 were collected by the writer, cases numbered 201 to 300 were collected by E. H. Sutherland in the 1930’s, and cases number 301 to 400 are from other sources.” CRESSEY, *supra* note 34, at 170 n.3. These numbers are oddly round and do not seem to correspond to other figures in the book. That is, Cressey states in the text of the book that his interview sample consisted of 133 inmates, *see id.* at 25—not 200—and that Sutherland had collected approximately 200 cases, *id.* at 30—not 100.

inconsistent with those criteria.⁷⁶ Cressey quotes from multiple case files to provide examples of each of the three criteria.⁷⁷

2. Critiques of Cressey's Work, and Subsequent Studies of Embezzlement

Cressey's approach has the virtue of developing out of interviews a succinct theory about why otherwise (presumably) honest individuals embezzle. However, it suffers from some deficiencies, particularly when extended beyond the population that Cressey studied. First, the analytic-induction methodology is itself an issue. Most notably, it lacks predictive power, serving only to describe the cases that have already been identified,⁷⁸ as Cressey recognized.⁷⁹ Also, because Cressey did not "us[e] the more straightforward method of strict hypothesis testing[,] Cressey may well have forced his interpretations to fit his theme."⁸⁰ In addition, Cressey did not talk to trusted individuals who were *not* known to have committed a trust violation, to see if they shared the three factors,⁸¹ so his study was not designed to have a control group. Instead, Cressey considered "each trust violator his own 'control' since each of them at a prior time had been a non-violator."⁸²

⁷⁶ CRESSEY, *supra* note 34, at 30. Some of the cases Cressey did not collect himself lacked "crucial information" relating to Cressey's hypothesis. *Id.*

⁷⁷ *See id.* at *e.g.*, 37 (quoting from multiple case files relating to a non-shareable problem); *id.* at 81 (quoting from two case files relating to opportunity on just that page); *id.* at 103 (quoting from a case file relating to the "borrowing" rationalization).

⁷⁸ Jonson & Geis, *supra* note 45, at 225 (analytic induction "contains a major shortcoming from a scientific viewpoint in that it is not possible to use it for predictive purposes."); *see also id.* ("The death rite for analytic induction was pronounced by John Laub and Robert Sampson in 1991: 'No empirical research today is guided by the theory' (p. 1419)."); Robert Schafer, *Review of Other People's Money : A Study in the Social Psychology of Embezzlement*, by Donald R. Cressey, 3 INT'L REV. OF MODERN SOCIOLOGY, 114, 116 (Mar. 1973) ("In effect, the theory is limited to a *post factum* explanation of behavior. The reason for this lack of predictive capacity is that there is no basis for determining beforehand if the conditions specified as necessary for embezzlement will exist in a particular case.").

⁷⁹ CRESSEY, *supra* note 34, at 153 ("The theory which we have presented has few practical applications either for prevention or detection of trust violation or for treatment of apprehended offenders.").

⁸⁰ Green, *supra* note 58, at 102.

⁸¹ CRESSEY, *supra* note 34, at 22-25.

⁸² *Id.* at 70. *See also id.* at 31 (finding as "evidence of validity" that none of the cases contradicted his hypothesis). However, "[t]rust violators had to report whether in the past they conceived of themselves as having had any other non-shareable financial problem, whether adequate rationalizations and the other factors were present at the time, data which would appear difficult to recall because they required subjective interpretations of past events rather than facts." Clinard, *supra* note 75, at 363. *See also id.* ("It is also likely that the length of time the violators in the sample had been in a position of trust, whether for a few months or a number of years, would appear to be important factors in recalling past situations. Some of these difficulties would have been avoided if an actual control group, probably a sample of persons who were at the time in a position of trust, had been interviewed to ascertain whether all parts of the generalization were present without violation.").

Cressey also discusses a case in the literature that included consideration of the brother of an inmate who, like the inmate, was a bank manager, but who had not embezzled. CRESSEY, *supra* note 34, at 45-47.

Second, the interview methodology means that Cressey relied on the inmates' recollection of past events. It is possible that their recollections regarding the order of events was incorrect or distorted, perhaps in a systematic way. For example, some inmates may not have admitted to Cressey that they had also embezzled at previous times. Similarly, inmates interviewed after the fact may rationalize the embezzlement post-hoc as a problem they could not solve by legitimate means because it was not possible to share the quandary with others. In other words, convicted embezzlers may try to justify their actions this way even if at the time of the financial pressure, they did not regard the problem as non-shareable, but rather hit on a solution (embezzlement) that was non-shareable.⁸³ In addition, with respect to Cressey's argument that rationalization occurred before rather than after the offense, "Cressey may have erred . . . Instead, they may have been rationalizations that emerged afterward to repress feelings of guilt."⁸⁴

Third, Cressey interviewed only inmates, so his theory was largely derived from trust violators who were actually caught, prosecuted, found guilty, and incarcerated.⁸⁵ It is possible that the commonalities Cressey found would not be true of embezzlers who were not incarcerated.⁸⁶ For example, judges and juries may find trust violators who had a problem of an embarrassing nature such that the embezzler kept it secret less sympathetic or more "guilty" than individuals who embezzle for a non-illicit or altruistic motive, such as to help an ill family member. In other words, Cressey's study may suffer from selection bias when generalized beyond inmates.

Fourth, Cressey's findings may be culture-specific, reflecting the context for U.S. males in the early 1950s.⁸⁷ One aspect that may reflect Cressey's time and his focus on men is that some of his interviewees mentioned that they kept their financial troubles from their wives.⁸⁸ In

⁸³ See Alexander Schuchter & Michael Levi, *Beyond The Fraud Triangle: Swiss and Austrian Elite Fraudsters*, 39 ACCOUNTING FORUM 176, 184 (Sept. 2015) ("Data acquisition in this area of research commonly takes place after the perpetrator has committed a crime, so one might regard retrospective reflections—even if believed by offenders themselves—as being contaminated by post-event processes, rather than as a 'black box' flight recorder.").

⁸⁴ Green, *supra* note 58, at 102-03.

⁸⁵ CRESSEY, *supra* note 34, at 22-25.

⁸⁶ See Clinard, *supra* note 75, at 363 ("The results might be different if other samples of undetected violators, those discovered and not prosecuted because of restitution, etc., or those placed on probation were studied using his hypothesis.").

⁸⁷ Cf. Grace Mui & Jennifer Mailley, *A Tale Of Two Triangles: Comparing The Fraud Triangle With Criminology's Crime Triangle*, 28 ACCOUNTING RES. J. 45, 47 (2015) ("[T]he Fraud Triangle is unique to the societal context of the USA (Czielewski, 2012), which is a consequence of its origins in the USA (Cressey, 1953; Sutherland, 1940, 1944).").

⁸⁸ See CRESSEY, *supra* note 34, at 28 (referring to a "prisoner who stated that he believed that no embezzlement would occur if the trusted person always told his wife and family about his financial problems"); *id.* at 71 (quoting Case 116 as stating "Even my wife didn't know.").

Jonson and Geis state, "it is noteworthy that not one of the married men in the sample was able to share his dilemma with his wife." Jonson & Geis, *supra* note 45, at 226. It is not clear if Cressey covered this specific issue with every married inmate in the sample, however. Also, it appears that at least one or two of the men's wives knew of the financial difficulties at some point. See *supra* note 63. It is possible that the men Cressey excluded from the sample because they did not accept the position of trust planning to hold the money in trust in good faith had shared more information with their intimates.

fact, Cressey's "specific hypothesis . . . was unknowingly suggested by a prisoner who stated that he believed that no embezzlement would occur if the trusted person always told his wife and family about his financial problems, no matter what the consequences."⁸⁹ This obviously assumes a very specific set of roles, including an embezzler who is male and married to a woman.⁹⁰ In contrast with Cressey's findings, a 1974 article by Nettler considering six Canadian embezzlement cases notes that in one case "the 'problem,' how to keep the beloved land, was not unshared. It was fully and repetitively discussed with the embezzler's wife."⁹¹

Fifth, Cressey's work has been criticized as focusing on "individualistic explanations of criminal behavior . . . , overlooking the micro-sociological (one's immediate social and organizational environment) as well as macro-sociological explanations (broader historical, economic, and political factors)."⁹² Morales et al. state that Cressey's work is thus "based on a very particular conception of white-collar crime that marginalizes social environments and circumstances."⁹³

Given the limits of Cressey's sample and study design, Cressey's three factors should not be viewed as a definitive statement regarding the causes of embezzlement, even when examining the problem from an offender-focused perspective. And in fact, Cressey regarded the project as one in search of a case that would falsify his hypothesis.⁹⁴ Subsequent studies have found cases that are inconsistent with Cressey's factors. For example, Nettler's 1974 article on six Canadian cases involving large embezzlements found that "in only *one* of these six instances was it possible to construct a parallel between the embezzling career Cressey portrays and the facts of our Canadian cases."⁹⁵ Nettler noted the absence of a non-shareable problem, stating, "[d]esire and opportunity generate theft more frequently in these instances than does a financial difficulty kept privy."⁹⁶ Nettler finds that "[t]hese five exceptions to Cressey's singular road to fraud are more clearly described as individuals who wanted things they could not afford and who were presented with (or who invented) ways of taking other people's money."⁹⁷

⁸⁹ CRESSEY, *supra* note 34, at 28.

⁹⁰ Some of the inmates' wives may have been kept in the dark about their husbands' finances more broadly. At least one of Cressey's interviewees mentioned that his wife did not know how much he earned. *See* CRESSEY, *supra* note 34, at 43 (citing Case 33 as stating that his wife "never knew how much I made."); *cf. id.* at 50 (reporting in Case 99, "I gave [my wife] the impression all along that I'm going great guns. Why should I tell her and worry her about it?"); *id.* at 62 (quoting Case 305, "I suppose I should explain here, that I never bothered [my wife] with any of my troubles; after all, she was concerned with raising the children—she had a tough enough time of it.").

⁹¹ Nettler, *supra* note 49, at 73-74.

⁹² Morales et al., *supra* note 38, at 176.

⁹³ *Id. Cf.* Schucter & Levi, *supra* note 83, at 185 ("Granted, as is usually the case with models, the FT does still offer an incomplete but useful abstraction of complex interactions, it nevertheless neglects the impact of social systems on individual decisions to commit fraud.").

⁹⁴ CRESSEY, *supra* note 34, at 32.

⁹⁵ Nettler, *supra* note 49, at 74.

⁹⁶ *Id.*

⁹⁷ *Id.* at 73-74.

In 1981, Dorothy Zietz published a study on female trust violators that compared Cressey's findings with her study of female inmates in the California Institution for Women.⁹⁸ For purposes of comparing her findings with Cressey's, Zietz excluded from her initial sample inmates who had an ex ante intent to steal or defraud.⁹⁹ She found that the "opportunity" aspect applied just as it had in Cressey's study.¹⁰⁰ However, she found differences with respect to the other two factors, with differences from Cressey's first factor (a non-shareable problem) most substantial. She concluded that, although her findings could not necessarily be extrapolated to all female trust violators, she had found negative cases that did not fit Cressey's three-part generalization.¹⁰¹

With respect to the first factor, Zietz found that "[m]ost of the women who violated positions of trust did not face the type of financial problem Cressey described as non-shareable"¹⁰² In some cases, the financial need was caused by a husband or child's need for medical care—a "shareable" type of problem.¹⁰³ In other cases, the embezzler was encouraged by or trying to retain the affections of her husband,¹⁰⁴ so the situational context was not kept from him. Zietz summarized her finding on this factor as follows: "[T]he problems of these women usually stemmed from situations in which additional funds were needed to permit them to fulfill the roles they had been conditioned to perceive as their primary reason for being—their roles as wives, mothers, grandmothers, or daughters who must fulfill parental expectations."¹⁰⁵

Zietz found that Cressey's third factor, rationalization, applied to her cases, as well, but that additional rationalizations were possible. She explains, "cultural ideologies affecting the development of their role models (such as wife, mother, and daughter) will need to be recognized as possible sources for the vocabularies of adjustment used by women."¹⁰⁶

Thus, Cressey and Zietz found different commonalities among the convicted embezzlers they each studied. Yet both of them, as well as Svend Riemer, whose work is discussed below,¹⁰⁷ found three common factors central to embezzlement and similar trust violation: (1) a financial motive, (2) an opportunity to commit the embezzlement, and (3) a role for psychological aspects in the offender's decision-making.

⁹⁸ DOROTHY ZIETZ, *WOMEN WHO EMBEZZLE OR DEFRAUD* 23-24 (1981). The initial sample was 100 women. *Id.* at 24.

⁹⁹ *Id.* at 25. She considers those women separately, but it is not clear how many women that included. *See id.* Part III.

¹⁰⁰ *Id.* at 62. Zietz notes that "most of the women had been employed as bookkeepers, accountants, or clerks in some way responsible for other people's money" *Id.*

¹⁰¹ *Id.* at 77. Zietz recognizes possible selection bias: "[F]urther research is needed to determine . . . whether the results are skewed by the fact that many women are not sentenced to state prison after trust violation (for example, women with small children, or women able to plea bargain when employers are reimbursed by relatives or a bonding company). *Id.*

¹⁰² *Id.* at 75.

¹⁰³ *Id.* at 76.

¹⁰⁴ *Id.* at 76.

¹⁰⁵ *Id.* at 76.

¹⁰⁶ *Id.* at 77.

¹⁰⁷ *See infra* text accompanying notes 143-154.

B. *Beyond the Fraud Triangle*

Scholars have proposed adding a variety of additional variables to the fraud triangle.¹⁰⁸ Such scholars have variably proposed:

converting it geometrically to a fraud diamond (Wolfe and Hermanson, 2004 who propose a fourth dimension of *capability*), fraud square (Cieslewicz, 2010 who adds the notion of *societal influences*), fraud cube (Doost, 1990 who argues that computer crime has three additional dimensions—*relationship*, *expertise* and *motivation*) or fraud pentagon (Marks, 2009 who adds the dimensions of *arrogance* and *competence*, or Goldman, 2010 who adds the dimensions of *personal greed* and *employee disenfranchisement*).¹⁰⁹

1. The Fraud Diamond

The paper in this vein that has gotten the most traction is a 2004 article by David T. Wolfe and Dana R. Hermanson.¹¹⁰ That article proposes to add to the fraud triangle a fourth factor, resulting in what Wolfe and Hermanson termed the “fraud diamond.”¹¹¹

The fourth factor is “an individual’s *capability*” to perpetrate the fraud.¹¹² Donald Cressey’s second factor, “the knowledge or awareness that this problem can be secretly resolved by violation of the position of financial trust,”¹¹³ arguably at least partly embodied capability. That is, identifying and availing oneself of an opportunity involves some skill. However, Cressey’s second factor focused more on the perceived opportunity to cheat than on the skills involved with carrying out the trust violation and covering it up.

Wolfe and Hermanson list a longer set of capabilities that includes the knowledge and intelligence necessary to carry out the fraud, as well as the skills needed to avoid detection:¹¹⁴

- “[T]he person’s position or function within the organization,” which can give unique opportunities;

¹⁰⁸ See Free, *supra* note 7, at 178. In addition, “Some scholars have sought to augment it with other theoretical models in criminology . . .” *Id.* (citations omitted).

¹⁰⁹ *Id.*; see also Maria Vassiljev & Lehte Alver, *Concept and Periodisation of Fraud Models: Theoretical Review*, 5TH INT’L CONF. ON ACCT., AUDITING & TAX’N 473, 478 tbl. 1 (2016) (providing a “[c]hronology and concept of fraud models”).

¹¹⁰ Free, *supra* note 7, at 178 (“The extension that has gained the most attention has been the addition of a fourth leg of capability by Wolfe and Hermanson’s (2004) fraud diamond . . .”).

¹¹¹ Wolfe & Hermanson, *supra* note 11, at 38.

¹¹² *Id.* (emphasis added).

¹¹³ Cressey, *supra* note 49, at 578.

¹¹⁴ Wolfe & Hermanson, *supra* note 11, at 39 (“[A] successful fraudster lies effectively and consistently. To avoid detection, she must look auditors, investors, and others right in the eye and lie convincingly. She also possesses the skill to keep track of the lies, so that the overall story remains consistent.”)

- intelligence and skill, including education and experience in the organization;
- “a strong ego and great confidence that he will not be detected”;
- the ability to “coerce others to commit or conceal fraud”;
- the ability to lie skillfully, consistently, and convincingly; and
- the ability to handle stress.¹¹⁵

While some of these factors may not be needed for all frauds, they suggest that not everyone can seize an opportunity to commit fraud.

2. The Role of Experiential Learning

An aspect that the fraud triangle’s prongs do not specifically address is *learning from the embezzlement experience*—learning that trust violations are not promptly detected. Cressey likely did not focus on this issue because his interest was in what prompted someone who was trusted to first betray that trust.¹¹⁶ Some learning may lead to subsequent violations. That is, someone who starts by embezzling a small amount may increase it over time, both as financial pressures or desires increase but also as the early violations go undetected.

Learning may relate to the “opportunity” element because undetected early violations may make the opportunity seem to continue or enlarge. In addition, learning may affect the rationalization aspect because learning that not all violations of trust are detected may help empower the individual to rationalize that the funds are not being missed or that the behavior is not that bad since it is not being punished. For example, in Cressey’s Case 56, discussed in connection with the awareness of the opportunity, the individual states:

I needed money very badly, and at first I didn’t think of taking it from company funds. . . . I sat up all one night drinking In the morning, I . . . went down to work and took some money (\$150) out of the safe. I reasoned that I was going to pay it back in three or four days, and I did pay it back. In a matter of a few days, I took some more—it got easier as time went on. . . . The most I ever took out was about \$1,000 in one twenty-four hour period.¹¹⁷

In this example, the individual faced financial pressure (the first element of the triangle), eventually identified the opportunity to take money from the safe at work (the second element), and rationalized it as a loan (the third element). The process of “borrowing” and “repaying” provided learning that made the process easier and allowed him to increase over time the amount taken.

¹¹⁵ *Id.* at 39-40.

¹¹⁶ *See supra* text accompanying note 50.

¹¹⁷ CRESSEY, *supra* note 34, at 90.

The situation that Bruce McNall, a coin-dealer and entrepreneur who eventually plead guilty to bank fraud,¹¹⁸ describes in his co-authored autobiography, *Fun While It Lasted*,¹¹⁹ provides another illustration and something of a case study. McNall's financial troubles apparently began when the largest client of his business selling ancient coins, Bunker Hunt, was trying to sell a substantial amount of silver.¹²⁰ The client's difficulties had arisen because, after silver was selling for as high as \$50 per ounce in January 1980, "[b]y early spring, Bunker . . . [was] committed to buy vast quantities of silver at \$35 an ounce in a market where it was worth about \$12."¹²¹

McNall explains that, when he

presented [Bunker] with a list of ancient coins I thought he should buy, Bunker suggested a bit of creative financing that would help him shed more silver than the law allowed. Instead of paying cash for the coins, he would give me, in private, \$20 million worth of silver that he had in storage . . . I could sell it right away or hold it.¹²²

This was attractive to McNall because, "[a]t the time, silver was about \$10 per ounce. Bunker was working . . . to try to make the price go back up. He was sure that the market was just a short-term dip."¹²³ Although Bunker did not know it, McNall did not actually have the coins he had suggested that Bunker buy.¹²⁴ McNall decided to "gamble with the price of silver" and hope to make a few million dollars once the price rose, then acquire the coins.¹²⁵ McNall explains that "I took the risk with Bunker's investment because my relationship with him had grown so close, so familiar. I also felt comfortable doing it because I was making lots of money for him, especially with horses. . . ."¹²⁶

Unfortunately for McNall, the value of silver declined to \$6 an ounce and McNall did not have the funds to buy the coins.¹²⁷ McNall rationalized lying to Bunker about his possession of the coins on the basis of numerous favors he had done for Bunker in the past, including money

¹¹⁸ See *Sports Executive Enters Guilty Plea*, N.Y. Times (Dec. 15, 1994), <https://www.nytimes.com/1994/12/15/business/sports-executive-enters-guilty-plea.html>.

¹¹⁹ BRUCE MCNALL WITH MICHAEL D'ANTONIO, *FUN WHILE IT LASTED* (2003). "Nick Cassavetes . . . has signed on to write a pilot for a drama based on the life of . . . McNall." IMDB, *Nick Cassavetes Developing Drama About Disgraced NHL Owner Bruce McNall* (Dec. 8, 2017), <https://www.imdb.com/news/ni61802097>.

¹²⁰ MCNALL WITH D'ANTONIO, *supra* note 118, at 71.

¹²¹ *Id.* at 68.

¹²² *Id.* McNall does not express concern about financing that was apparently designed to circumvent applicable law. In part, that may be because of the value to the client to him, but other descriptions in the book suggest that McNall was already comfortable at that point with some level of legal transgressions (such as smuggling coins out of Tunisia). See *infra* text accompanying notes 134-138.

¹²³ MCNALL WITH D'ANTONIO, *supra* note 118, at 68.

¹²⁴ *Id.* at 71.

¹²⁵ *Id.* at 72.

¹²⁶ *Id.* at 72.

¹²⁷ *Id.* at 73. Schuchter & Levi state regarding the first element of the fraud triangle, "What was once a mere incentive can turn into pressure to continue." Schuchter & Levi, *supra* note 33, at 110.

McNall had lost¹²⁸ in helping Bunker report a tax loss.¹²⁹ When auditors demanded to see the coins, McNall, with the help of his staff, bought some of the coins on the list, borrowed some, and relabeled another important client's coins.¹³⁰

Unexpectedly, the auditors took the collection McNall had labelled as Bunker's, making McNall unable to return the coins as planned.¹³¹ McNall learned from this experience that his staff would help him unquestioningly:

I was pleasantly surprised when not one person hesitated to help. But I was astounded when, in the end, not one person pointed out that I had been reckless, even fraudulent, in my dealings. Later I would realize that they were all too dependent on me to see any other course.¹³²

He further describes what he learned from this experience as follows: "When it was all over, the lesson I took from the experience was probably the wrong one. Rather than feeling chastened and humbled, I felt as if I had made a great escape. I had taken a risk and survived."¹³³

Although this series of events seems to have been where the trouble that eventually landed McNall in prison began, it does not appear to be his first transgression. He describes smuggling coins out of Tunisia as a young man, where "the removal of antiquities was punishable by a twenty-year prison term."¹³⁴ McNall explains that this was before most airports had metal detectors, so he and his traveling companion, the sixteen-year-old son of an ancient coin expert,¹³⁵ "selected the most valuable ones and put them in our pockets, in our shoes, even in the cuffs of our pants. The rest . . . were . . . distributed in our luggage."¹³⁶ When asked at the airport if they "were transporting any national treasure," they simply said no.¹³⁷ This type of experience may also have involved learning that opportunities existed for enrichment despite legal prohibitions.¹³⁸

¹²⁸ MCNALL WITH D'ANTONIO, *supra* note 118, at 73. ("The millions of dollars I had shoveled to Bunker for horses; the Tunney-brokered bailout; the \$650,000 I lost in the New Year's Eve silver deal; all of this was on my mind as I continued to lie to Bunker about the coins I had supposedly bought for him after he gave me all that silver.").

¹²⁹ *Id.* at 64 (describing a New Year's Eve transaction).

¹³⁰ *Id.* at 74-76.

¹³¹ *Id.* at 76-77.

¹³² *Id.* at 74.

¹³³ *Id.* at 78.

¹³⁴ *Id.* at 32.

¹³⁵ *Id.* at 8 (describing Joel Malter); *id.* at 24 (referring to Malter's sixteen-year-old son, Michael); *id.* at 32 (describing how McNall and Michael got the coins out of Tunisia).

¹³⁶ *Id.* at 32-33.

¹³⁷ *Id.* at 33.

¹³⁸ McNall later explains in connection with another potential coin purchase:

Like every other retailer in the world, I wasn't much concerned with the coins' origins. If you investigate thoroughly you will discover that at some point, virtually every ancient coin on the market was smuggled, stolen, or otherwise the subject of shady dealing. . . .

It's a state of affairs that's widely accepted, even by law-enforcement authorities, and only leads to problems when questions about a sale become public.

Id. at 64.

II. Resolving Misconceptions About the Fraud Triangle

Some of the origins of the fraud triangle, including the source of its name, are subject to differing claims in the accounting literature. This Part seeks to resolve confusion after the origins and development of the fraud triangle.

A. *The Source of Cressey's Factors*

The nature or source of Cressey's factors is sometimes disputed. For example, one scholar has argued that Cressey's three factors are "loosely based on what policemen and detectives have referred to as 'means, motives, and opportunity.'"¹³⁹ Cressey's first factor, a non-shareable problem, involves motive, and Cressey does list opportunity (which may include means).¹⁴⁰ However, Cressey's third factor, "rationalization,"¹⁴¹ focuses on psychological aspects of the violation.

Potentially more controversially, Schuchter and Levi point to a source other than Cressey for the idea behind the fraud triangle. They state "Cressey [is] cited as the most influential developer of the FT—though the original idea came largely from a European, Riemer (1941)"¹⁴² Svend Riemer, who, like Sutherland and Cressey, was a sociologist, wrote about embezzlement before Cressey did, although Riemer had a different focus. Riemer's 1942 article, "Embezzlement: Pathological Basis," was based on analysis of the case files of 100 convicted embezzlers from a "prison clinic in Stockholm, Sweden."¹⁴³ The inmates in the prison clinic were those for whom someone had raised the defense of not guilty by reason of insanity.¹⁴⁴ Riemer's focus seems to have been to group cases under the various types of pathologies he observed in the 100 cases he studied.¹⁴⁵

In his article, Riemer lists three factors relevant to the embezzlement in the population he studied. The source of the three factors is not clear, but Riemer uses them to categorize his cases. Riemer's factors are: "1) the social pull; the *opportunity*[;] 2) the social push; the *emergency*

¹³⁹ Ramamoorti, *supra* note 72, at 525.

¹⁴⁰ "Means" may be more analogous to the fourth factor added by the "fraud diamond": capability. See *supra* text accompanying notes 110-115 (discussing the fraud diamond).

¹⁴¹ See Cressey, *supra* note 49, at 578.

¹⁴² Alexander Schuchter & Michael Levi, *Beyond The Fraud Triangle: Swiss and Austrian Elite Fraudsters*, 39 ACCOUNTING FORUM 176, 177 (Sept. 2015).

¹⁴³ Svend Riemer, *Embezzlement: Pathological Basis*, 32 J. CRIM. LAW & CRIMINOLOGY 411, 411 n.1 (1941).

¹⁴⁴ *Id.* ("Only such cases are transferred to the prison clinic in behalf of which insanity is pleaded by either defense, judge or district attorney.").

Riemer's cases included both men and women. See *id.* at 423 (stating that "[i]n four cases only is the embezzlement the outcome of a sudden and irresistible desire to spend money lavishly for luxurious consumption" and distinguishing between how "[t]he two women in this category" spend the embezzled funds from how the two men do).

¹⁴⁵ Riemer found that "our 100 case studies suggests the elaboration of typical configurations of previously separated factors." *Id.* at 417.

situation[; and] 3) specific to our material; the *psycho-pathological element* involved.”¹⁴⁶ His focus was on the third factor, but he also discusses the first two factors for about two and a half pages each.¹⁴⁷

With respect to “opportunity,” Riemer pointed to trust that can be exploited by someone engaged in a business transaction.¹⁴⁸ Regarding the “emergency situation,” Riemer found that “[e]mbezzlement in the great majority of cases represents the only way out of an extreme economic emergency situation.”¹⁴⁹ A declining career, including risk of losing the family home, was a prime example.¹⁵⁰

Riemer’s “psycho-pathological” factor considered the psychiatric classification (or “pathological tendencies”¹⁵¹) of each individual.¹⁵² For example, he described some of the embezzlers as paranoid, depressive, manic, neurasthenic, or suicidal.¹⁵³ Some he labelled as suffering from alcoholism in addition to another classification.¹⁵⁴

Schuchter and Levi note that Cressey’s book cites Riemer in his discussion of opportunity, and “Riemer points out that a potential fraudster needs a situation, which offers an opportunity; a driving force in an emergency situation, which may consist of a plurality of environmental constellations; and psycho-pathological conditions have to be considered as well.”¹⁵⁵ Schuchter

¹⁴⁶ Riemer, *supra* note 143, at 411 (emphasis added).

¹⁴⁷ *See id.* at 411-414 (discussing “The Opportunity”); *id.* at 414-416 (discussing “The Emergency Situation”).

¹⁴⁸ *Id.* at 412 (““There are certain loopholes in society. They are based upon the fact that the individual member of the group must to some extent be trusted to adhere to certain folkways concerning money transactions. These loopholes represent the opportunities that are open to the embezzler.”).

¹⁴⁹ *Id.* at 414 (also stating, “[i]n most cases several elements of conflict cooperated.”).

¹⁵⁰ *Id.* (“The declining career poses against contrasting expectations of the environment. The family is often left unaware of the impending economic ruin. Embezzlement, in eight cases, means the last stand of defense against the necessity of giving up the family home.”).

¹⁵¹ *Id.* at 416 (considering the “traditional psychiatric classification of reaction patterns as an additional approach to the discussion of pertinent environmental constellations.”). Riemer stated that his “interest is related entirely to the ensuing distortion of the definition of the situation. *Id.*”

¹⁵² *Id.* at 419 tbl.3.

¹⁵³ *Id.* Neurasthenia is “an ill-defined medical condition characterized by lassitude, fatigue, headache, and irritability, associated chiefly with emotional disturbance.” OXFORD ENGLISH DICTIONARY, <https://en.oxforddictionaries.com/definition/neurasthenia>.

The table in Riemer’s article containing these labels is of “those 15 cases which closely approach the sociogenetic type” of “[e]mbezzlement in the civil service and in similar public functions,” which Riemer found “occurs in [his] material under circumstances which show great similarity from case to case.” Riemer, *supra* note 143, at 417. In some of these individuals, Riemer did not find pathological tendencies. *See id.* at 419 tbl.3 (noting no such tendencies in Case 74, involving a Post Official, and Case 77, involving a Police Officer).

¹⁵⁴ Riemer, *supra* note 143, at 419 tbl.3.

¹⁵⁵ Schuchter & Levi, *supra* note 33, at 108.

and Levi “hypothesize that Cressey was strongly inspired by Riemer’s work when developing an initial Fraud Triangle approach.”¹⁵⁶

Cressey was aware of the importance of Riemer’s work. The “Review of the Literature” section of Cressey’s Ph.D. dissertation states that “only three sociologists have published detailed accounts of research on embezzlement.”¹⁵⁷ Riemer is one of them, and Cressey summarizes Riemer’s article.¹⁵⁸ Also, Riemer’s work, like Cressey’s, was influenced by Sutherland’s work.¹⁵⁹

Schucter and Levi do not mention, and it may not be well known, that Riemer and Cressey were colleagues at the University of California, Los Angeles (UCLA). Cressey joined UCLA’s “sociology faculty”¹⁶⁰ in 1950.¹⁶¹ He remained there until he moved to U.C. Santa Barbara in 1961.¹⁶² Riemer joined the UCLA Sociology faculty in 1952, moving there from the University of Wisconsin.¹⁶³ He remained at UCLA until he retired in 1972.¹⁶⁴ Thus, Cressey and Riemer were colleagues from 1952 to 1961. This includes the year in which Cressey’s book was published—1953—although Cressey had already completed his dissertation on the topic in

¹⁵⁶ *Id.* See also Alexander Schuchter & Michael Levi, *Beyond The Fraud Triangle: Swiss and Austrian Elite Fraudsters*, 39 ACCOUNTING FORUM 176, 177 (Sept. 2015) (“Cressey [is] cited as the most influential developer of the FT—though the original idea came largely from a European, Riemer (1941) . . .”).

¹⁵⁷ Donald Ray Cressey, *Criminal Violation of Financial Trust* 20 (1950) (unpublished Ph.D. dissertation, Indiana University) (on file with the author).

¹⁵⁸ *Id.* at 23-25.

¹⁵⁹ For example, Riemer used the term “white-collar criminal” in Sutherland’s sense of referring to the social class of the individual who committed the crime, and stated “[e]mbezzlement, obviously, is most frequent among the white collar group, though definitely not restricted to that stratum of society only.” Riemer, *supra* note 143, at 412.

Riemer distinguished his findings from Sutherland’s in the regard that “[i]n 45 of our 100 cases the criminal act did not require any other opportunities than those open to every citizen with average insight in the functioning of our most elementary economic institutions.” *Id.* Riemer argued that “If more extensive research should confirm these conditions, the theory of white collar crime originating in the professional atmosphere of civil service and business life might have to be somewhat revised.” *Id.*

¹⁶⁰ At UCLA, Sociology did not become its own department until 1964-1965. U.C.L.A. DEPARTMENT OF SOCIOLOGY, *History*, <https://soc.ucla.edu/content/history>.

¹⁶¹ Ronald L. Akers & Ross L. Matsueda, *Donald R. Cressey: An Intellectual Portrait of a Criminologist*, 59 SOC. INQ. 423, 424 (Nov. 1989). During his tenure there, “Cressey served as department chair and acting dean of the social sciences.” *Id.*

¹⁶² *Id.*

¹⁶³ *Svend Henry Riemer, Sociology: Los Angeles*, CALISPHERE, <http://texts.cdlib.org/view?docId=hb4q2nb2nd;NAAN=13030&doc.view=frames&chunk.id=div00056&oc.depth=1&toc.id=&brand=calisphere>. Riemer had moved to the United States in 1938. *Id.* Before the University of Wisconsin, he was a faculty member at the University of Minnesota, the University of Washington, and Cornell University.

¹⁶⁴ *Id.*

1950,¹⁶⁵ based on interviews conducted in one of the three penitentiaries where he eventually interviewed inmates.¹⁶⁶

In his book, Cressey describes developing a series of hypotheses based on the work of previous scholars. Cressey's first hypothesis was based on Sutherland's writing on white collar crime¹⁶⁷ and was that

the incumbent has learned in connection with the business or profession in which he is employed that some forms of trust violations are merely "technical violations" and are not really "illegal" or "wrong," and, on the negative side, that they are not violated if this kind of definition of the behavior has not been learned.¹⁶⁸

Cressey states that he quickly rejected this first hypothesis because some of the interviews said they did not know anyone else behaving similarly, some defined the behavior as theft, and "many trust violators expressed the idea that they knew the behavior to be illegal and wrong at all times and that they merely 'kidded themselves' into thinking that it was not illegal."¹⁶⁹

Cressey then developed a second hypothesis "in part based on Riemer's observation that the 'opportunities' inherent in trust positions form 'temptations' if the incumbents develop anti-social attitudes"¹⁷⁰; abandoned that based on interviewees' statements; shifted to a hypothesis involving the "psychological isolation" of a non-shareable problem, based on work by LaPiere and Farnsworth;¹⁷¹ rejected that one for the same reason; and ultimately formed the fifth hypothesis, for which he did not find a negative case.

Thus, Cressey was influenced by prior work on white-collar crime and embezzlement, but his focus was different from Riemer's. Riemer was interested in the connection between

¹⁶⁵ See Akers & Matsueda, *supra* note 161, at 424 ("In 1950, Cressey completed his dissertation on embezzlement and joined the sociology faculty at the University of California at Los Angeles.").

¹⁶⁶ See Cressey, *supra* note 157, at 40 ("The main source of direct information on trust violators was interview material obtained from prisoners at the Illinois State Penitentiaries at Joliet, Illinois.")

Cressey conducted the Chino, California interviews from October 1950 to May 1951, CRESSEY, *supra* note 34, at 22-23, presumably after he moved to California. He conducted the Terre Haute, Indiana interviews from June to August 1951. *Id.* at 23. This was to add a federal prison. See *supra* note 51.

¹⁶⁷ This was the case despite the fact that in his book, Cressey stated that the trust-violation crimes he studied did not constitute "white-collar crime" as defined by Sutherland:

As a class of crimes, trust violation cannot be considered a "white collar crime."

Sutherland has defined that type of crime as violations of law by persons of respectability and high social status in the course of their occupations. . . . While the crimes of trust violation are committed in the course of their occupations, many of the violators cannot be considered as persons of high social status or as respected persons of the community.

Id. at 184 n.9 (citing SUTHERLAND, *supra* note 43).

¹⁶⁸ *Id.* at 27 (citing SUTHERLAND, *supra* note 43).

¹⁶⁹ *Id.*

¹⁷⁰ CRESSEY, *supra* note 34, at 27.

¹⁷¹ *Id.* at 28.

pathology and trust violation, while Cressey was interested in what caused a previously trustworthy person to commit the first trust violation. The three factors on each list share the “opportunity” factor but differ in the other respects. They differ most on the third factor, with Riemer pointing to a “psycho-pathological element” and Cressey to a mere “rationalization.”¹⁷²

B. The Factors’ Path From Embezzlement to Fraud

As noted above, AICPA standards reflect the teachings of the fraud triangle.¹⁷³ Several scholars explain that after high-profile accountants were convicted of fraud,¹⁷⁴ the AICPA adopted the fraud triangle approach from the Association of Certified Fraud Examiners (ACFE).¹⁷⁵ For example, Donegan and Ganon state that, “When the AICPA belatedly recognized the need to consider why so many accountants were committing fraud they turned to the ACFE, which, in effect, meant embracing Cressey’s perspective.”¹⁷⁶

The ACFE was founded in 1988 by Joseph T. Wells.¹⁷⁷ Wells was heavily influenced by Cressey.¹⁷⁸ In the early 1980s, Wells had connected with Cressey, and Wells “ascribes much of the credit for the founding of the ACFE to his relationship with Cressey.”¹⁷⁹ “The ACFE’s mission is ‘to reduce the incidence of fraud and white-collar crime and to assist the Membership

¹⁷² Compare *supra* text accompanying note 146 (discussing Riemer’s third factor) with *supra* text accompanying notes 68-69 (discussing Cressey’s third factor).

¹⁷³ See *supra* text accompanying note 14.

¹⁷⁴ James J. Donegan & Michele W. Ganon, *Strain, Differential Association, and Coercion: Insights from the Criminology Literature on Causes of Accountant’s Misconduct* 8 ACCOUNTING & THE PUB. INTEREST 1, 3 (2008).

¹⁷⁵ See *id.* at 3; Mark E. Lokanan, *Challenges To The Fraud Triangle: Questions On Its Usefulness*, 39 ACCOUNTING FORUM 201, 207 (2015) (“Concerned about the erosion of ethical standards within the accounting profession, the American Institute of Certified Public Accountants (“AICPA”) in 2002 and the International Federation of Accountants (“IFAC”) in 2006, followed the ACFE’s footsteps and turned to Cressey’s (1953) work on the fraud triangle for potential explanations of the frauds”); Morales et al., *supra* note 38, at 182 (stating that “[t]he ACFE’s claim to expertise, grounded in the imagery of the triangle, spread beyond its confines,” to both ISA 240 and to the AICPA in SAS No. 99).

¹⁷⁶ Donegan & Ganon, *supra* note 174, at 3.

¹⁷⁷ Morales et al., *supra* note 38, at 179. Wells has a CPA and is a CFE (certified fraud examiner). <https://www.acfe.com/bio-jwells.aspx>.

¹⁷⁸ WELLS, *supra* note 39, at 21-22 (describing his friendship with Cressey and stating that “although Cressey didn’t know it at the time, he created the concept of what eventually became the Certified Fraud Examiner.”).

¹⁷⁹ Donegan & Ganon, *supra* note 174, at 3.

Every year since 1989, the ACFE has bestowed the Cressey Award “for a lifetime of achievement in the detection and deterrence of fraud” on a member who best contributed to “the fight against fraud.” The Award is named “in honor of one of the country’s foremost experts on fraud and a founding father of the ACFE, Dr. Donald R. Cressey” (Association of Certified Fraud Examiners (ACFE), 2013).
Morales et al., *supra* note 38, at 179.

in fraud detection and deterrence.”¹⁸⁰ The ACFE touts the fraud triangle as assisting in the detection of fraud.¹⁸¹

Donegan and Ganon find “problematic . . . the generalization from a sample of embezzlers to those who have committed financial statement fraud.”¹⁸² Fraud and embezzlement are not identical. *Black’s Law Dictionary*’s first definition of fraud is “[a] knowing misrepresentation or knowing concealment of a material fact made to induce another to act to his or her detriment.”¹⁸³ Fraud is thus a fairly broad category. By contrast, embezzlement is fairly narrow. *Black’s Law Dictionary* defines embezzlement as “[t]he fraudulent taking of personal property with which one has been entrusted, especially as a fiduciary.”¹⁸⁴

Given Donegan and Ganon’s critique, it is worth examining how Cressey’s work was extended to financial statement fraud. Recall that Cressey’s factors were (1) a non-shareable problem; (2) a perceived opportunity; and (3) rationalization, while the fraud triangle factors adopted by the AICPA are (1) incentive or pressure; (2) a perceived opportunity; and (3) character or rationalization.¹⁸⁵ Thus, the factors that Cressey developed in his study of

¹⁸⁰ Morales et al., *supra* note 38, at 179. The ACFE provides anti-fraud training, and it provides a certification called “Certified Fraud Examiner.” ACFE, *membership and Certification*, <https://www.acfe.com/membership-certification.aspx>. Mark Lokanon has criticized the ACFE’s use of the fraud triangle, in part because the ACFE has something to sell: “it makes sense that the ACFE uses the fraud triangle because the fraud triangle validates its very existence. The theory here, in short, is that one’s chosen solution(s) actually specify or constitute the very problem that needs to be addressed.” Lokanon, *supra* note 174, at 207.

¹⁸¹ See Morales et al., *supra* note 38, at 177 (“We found a . . . tendency to generalize in . . . ACFE documents, suggesting that ACFE representatives are highly confident in the knowledge base that allegedly underlies the fraud triangle concept. . . . [T]he knowledge base claimed by the ACFE is presented as universal.”); ACFE, “Why Do People Commit Fraud?”, YouTube, <https://www.youtube.com/watch?v=oJIWg7jRkys> (describing the video as follows: “Explore how pressure, opportunity and rationalization—called the Fraud Triangle—can come together to influence an individual to commit fraud in this video courtesy of the Association of Certified Fraud Examiners.”).

¹⁸² Donegan & Ganon, *supra* note 174, at 3; see also Wm. Dennis Huber, *Forensic Accounting, Fraud Theory, and the End of the Fraud Triangle*, 12 J. OF THEORETICAL ACC’T RES. 28, 30 (2017) (arguing that “the fraud triangle . . . as originally developed and modified, has been misused, abused, contorted, stretched out of shape, and pressed into uses for which it was not intended and cannot possibly accommodate.”).

Donegan and Ganon add, “[t]he white-collar crime literature has generally stratified offenders into higher and lower status categories, with securities law violators in the former group and embezzlers in the latter These studies have found significant differences between high and low status offenders” *Id.*

¹⁸³ BLACK’S LAW DICTIONARY 775 (10TH ED. 2014) (Bryan A. Garner, ed.); cf. SAS No. 99—*Consideration of Fraud in a Financial Statement Audit*, <http://users.ipfw.edu/pollockk/sas99.pdf> (“For purposes of this Statement, *fraud* is an intentional act that results in a material misstatement in financial statements that are the subject of an audit.”).

¹⁸⁴ BLACK’S LAW DICTIONARY, *supra* note 183, at 635. Note that embezzlement does not involve fraud in the receipt of the property, as the property is received legitimately but in a trustee or fiduciary capacity. However, embezzlement involves fraud in the conversion of the property to one’s own use. See *id.*

¹⁸⁵ See *supra* text accompanying notes 58-68.

embezzlers were not simply carried over to the financial statement fraud context. The first and third factors the AICPA use differ somewhat from Cressey's factors.

There also seems to be some confusion regarding the source of these changes. Morales et al. link both of these changes to Joseph Wells, the founder of the ACFE, stating “[a]s in Wells’ writings (1997), the non-shareable financial problem has disappeared and been replaced by an incentive or pressure to commit fraud, while the notion of rationalization is linked with that of attitude, thus shifting closer to the idea of individual morality.”¹⁸⁶ The cite is to Wells’ 1997 book, *Occupational Fraud and Abuse*.¹⁸⁷ However, that does not appear to be the source of the changes. With respect to the first factor, Wells does not introduce the phrase “incentive or pressure.” Instead, Wells hews closely to Cressey in this regard. He states in part, “[t]he role of the nonsharable problem is important,”¹⁸⁸ and he includes a discussion under the heading “Nonsharable Problems”¹⁸⁹ after quoting Cressey’s list of three factors and summarizing them.¹⁹⁰

With respect to the third factor, Wells does not mention attitude or character per se, but he does say in the “Conclusion” section on Cressey’s work:

Our sense tells us that one model—even Cressey’s—will not fit all situations. Plus the study is nearly half a century old. There has been considerable social change in the interim. And now, many antifraud professionals believe there is a new breed of occupational offender—one who simply lacks a conscience sufficient to overcome temptation.¹⁹¹

Thus, Wells merely alludes to developments subsequent to Cressey’s work that affect the third prong.

The origins of the changes in these two prongs likely lie elsewhere, in research on fraud. In 1979, certified public accountant (CPA) Steve Albrecht and four other researchers conducted

¹⁸⁶ Morales et al., *supra* note 38, at 182 (citing WELLS, *supra* note 39).

Morales et al. argue that “SAS 99 recommends calling in fraud examiners—identified as key participants in the antifraud effort—to work with the organizations’ administrators and auditors” *Id.* at 183 (citations omitted). However, it appears that the reference to certified fraud examiners appears not in SAS No. 99 itself, *see* SAS No. 99, *supra* note 183, but in an exhibit that Morales et al. mention. *See* PCAOB, AU Section 16, *Exhibit—Management Antifraud Programs and Controls: Guidance to Help Prevent, Deter, and Detect Fraud*, <https://pcaobus.org/Standards/Auditing/Pages/AU316.aspx> (including a paragraph that begins, “Certified fraud examiners may assist the audit committee and board of directors with aspects of the oversight process either directly or as part of a team of internal auditors or independent auditors.”). Wells is thanked in the exhibit as part of the “Anti-Fraud Detection Subgroup.” *Id.*

¹⁸⁷ Morales et al., *supra* note 38, at 194.

¹⁸⁸ WELLS, *supra* note 39, at 11.

¹⁸⁹ *Id.* This section spans more than two pages and includes subheadings on types of non-shareable problems. *See id.* at 11-14. This section remains similar in a related book of his, JOSEPH T. WELLS, *CORPORATE FRAUD HANDBOOK: PREVENTION AND DETECTION 6-9* (2004), and subsequent editions of that book. *See, e.g.*, JOSEPH T. WELLS, *CORPORATE FRAUD HANDBOOK: PREVENTION AND DETECTION 7-10* (5th ed. 2017).

¹⁹⁰ WELLS, *supra* note 39, at 10.

¹⁹¹ *Id.* at 20.

a study for KPMG “to study fraud and how it could be detected.”¹⁹² Their approach was as follows:

[W]e both interviewed and studied many convicted fraud perpetrators and performed a comprehensive, interdisciplinary literature search related to why people commit fraud. As we examined the various sources and studied the fraud perpetrators, we compiled a comprehensive list of all variables that appeared to influence or be associated with the perpetration of fraud. In total, we identified 82 fraud-related variables. We classified these variables, which we called “red flags,” into three major categories representing the forces that influence the decision to commit or not commit fraud.¹⁹³

Based on this approach, Albrecht et al. “concluded, similarly to Cressey, that it was the combination of three forces that produces a fraudulent act”:¹⁹⁴ (1) “Situational pressures”, (2) “Opportunities to commit fraud”,¹⁹⁵ and (3) “Personal integrity (character).”¹⁹⁶ With respect to the first factor, Albrecht et al. found that, in fraud cases, Cressey’s first element did not have to involve something non-shareable.¹⁹⁷ Albrecht explains: “Rather, we concluded that *situational pressures* refer to the immediate pressures that individuals experience within their environments. . . . We concluded that the most overwhelming pressures are usually high personal debts or financial losses.”¹⁹⁸

This “situational pressure” factor is similar to the AICPA’s first factor, “incentive or pressure.”¹⁹⁹ However, “incentive” did not appear either in Cressey’s or Albrecht et al.’s first factor. In October 1987, the National Commission on Fraudulent Financial Reporting (known as the Treadway Commission, after its Commissioner) issued an influential report.²⁰⁰ The Treadway Commission’s report found that

¹⁹² Albrecht, *supra* note 10, at 3.

¹⁹³ *Id.*; see also Marshall B. Romney et al., *Auditors and the Detection of Fraud*, 149 J. ACCOUNTANCY 63, 65-69 (May 1980).

¹⁹⁴ Albrecht, *supra* note 10, at 3.

¹⁹⁵ Albrecht et al. found that opportunities to commit fraud can involve careless controls on the part of the employer, but can also involves openings “individuals create for themselves . . . such as [by] modifying the computer programs.” Albrecht, *supra* note 10, at 3.

¹⁹⁶ W. STEVE ALBRECHT ET AL., *HOW TO DETECT AND PREVENT BUSINESS FRAUD* (1982).

¹⁹⁷ Albrecht, *supra* note 10, at 3.

¹⁹⁸ *Id.* (emphasis added); see also Marshall B. Romney et al., *supra* note 193, at 64. The study also “dichotomized situational pressures into two groups: 1) those that encourage individuals to commit fraud for the company rather than against the company, such as not meeting analysts’ forecasts of revenues, gross margin or earnings, delisting from a stock exchange or having a cash shortage and 2) those that encourage individuals to commit fraud against organizations.” Albrecht, *supra* note 10, at 3.

¹⁹⁹ See *supra* text accompanying note 14. The rationalization aspect of the third factor was contained in Cressey’s work. See *supra* text accompanying note 68.

²⁰⁰ REPORT OF THE NAT’L COMM. ON FRAUDULENT FINANCIAL REPORTING (Oct. 1987), <https://www.coso.org/Documents/NCFFR.pdf>; see also SAS No. 99, *supra* note 183, at 106 n.3 (referring to the commission as the Treadway Commission).

In trying to ascertain the causes of financial reporting fraud, the Treadway Commission interviewed numerous experts and “the Commission’s staff completed more than 20 research projects and briefing papers, including analyses of SEC enforcement actions, pressures within public accounting firms,

fraudulent financial reporting usually occurs as the result of certain environmental, institutional, or individual forces and opportunities. These forces and opportunities add *pressures and incentives* that encourage individuals and companies to engage in fraudulent financial reporting and are present to some degree in all companies. If the right, combustible mixture of forces and opportunities is present, fraudulent financial reporting may occur.²⁰¹

This report was well received. For example, the Securities and Exchange Commission and some of its members praised the Treadway Commission's report.²⁰² SAS No. 99 cites the report.²⁰³ Thus, the "incentive" aspect may have come from that report.

The Albrecht et al. study also changed the third factor from "rationalization" to "personal integrity," and further "stated that it was easier for someone with lower or situational integrity to rationalize engaging in fraudulent behavior."²⁰⁴ The focus on personal character contradicts Sutherland's view that crime is determined by environment rather than by personal, moral failings. However, it is consistent with the AICPA's statement that "[s]ome individuals possess an attitude, character, or set of ethical values that allow them knowingly and intentionally to commit a dishonest act."²⁰⁵ Thus, Albrecht et al.'s work may have influenced the AICPA.

In the late 1980s, Loebbecke and Willingham developed a three-factor model. Their model:

asserts that for fraud to occur, (1) the *conditions of the entity* must be such that a material management fraud could be carried out; (2) the person or persons who would commit the fraud must have a *reason or motivation* for doing so; and (3) the person or persons who would commit the fraud must be of a *character* that would allow them to knowingly commit a dishonest, criminal act.²⁰⁶

AICPA self-regulatory programs, and the legal and regulatory environment." REPORT OF THE NAT'L COMM. ON FRAUDULENT FINANCIAL REPORTING, *supra*, at 3.

²⁰¹ REPORT OF THE NAT'L COMM. ON FRAUDULENT FINANCIAL REPORTING, *supra* note 200, at 23 (emphasis added).

²⁰² U.S. Sec. and Exchange Comm., *The Treadway Commission Report: Two Years Later* 4-6 (Jan. 26, 1989), <https://www.sec.gov/news/speech/1989/012689grundfest.pdf>.

²⁰³ SAS No. 99, *supra* note 183, at 106 n.3.

²⁰⁴ Albrecht, *supra* note 10, at 5.

Albrecht himself subsequently changed his own view on the "character" point: "Over time and through conducting many more research projects, I personally came to agree that Cressey's labeling of the third element as a way to rationalize the behavior as not being inconsistent with one's personal code of conduct was more accurate than our label of personal integrity." *Id.*

²⁰⁵ AICPA, *supra* note 14, at § 240.A1 (emphasis added); ISA 240, *supra* note 14, at A1 (emphasis added).

²⁰⁶ James K. Loebbecke et al., *Auditors' Experience with Material Irregularities: Frequency, Nature, and Detectability*, 9 AUDITING: A J. OF PRAC. & THEORY 1, 4 (1989) (emphasis added) (citing J.K. Loebbecke & J.J. Willingham, Jr., *Review of SEC Accounting and Auditing Enforcement Releases* (unpublished working paper 1988)). Loebbecke et al. argued that if any one of the three factors is not present, material management fraud will not occur. *Id.* at 5 fig.1.

In 1989, Loebbecke et al. published an article summarizing that model and applying it to the results of a survey of the audit partners of KPMG Peat Marwick.²⁰⁷ Notice that, in this model, the third factor is “character,” in line with Albrecht et al.’s identification of “personal integrity” and the AICPA’s identification of “attitudes.”

In sum, it appears that auditing standards, including those adopted by the AICPA, built upon research into the causes of fraud, including the work by Albrecht et al. and the Treadway Commission. That research had moved beyond Cressey’s embezzlement-related factors. It is therefore not surprising that the fraud triangle factors in U.S. and international auditing standards differ from Cressey’s embezzlement-related factors.

Donegan and Ganon have also criticized the AICPA standards for what they see as an approach that exonerates the culture of the employer:

Adopting the program of a group of dedicated fraud fighters was doubtlessly a useful way to burnish the profession’s tarnished image in 2002. The triangle had the added advantage of explaining fraud as the action of a loner driven by need, taking advantage of a lack of internal control. Thus the deterrent to fraud was more internal control, and *the search for the culprit could focus on individual offenders, not on the culture that may have encouraged and rewarded their actions.*²⁰⁸

However, in the “incentive or pressure” prong, the AICPA focuses first on employment-related pressures, and only then on lifestyle pressures:

Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, *from sources outside or inside the entity, to achieve an expected (and perhaps, unrealistic) earnings target or financial outcome*—particularly because the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets (for example, because the individuals are living beyond their means).²⁰⁹

In addition, in describing the “rationalization” prong, the AICPA refers to the individual’s environment, stating that “even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.”²¹⁰

²⁰⁷ *Id.* at 4-5, 15-19 tbl.9.

²⁰⁸ Donegan & Ganon, *supra* note 174, at 3 (emphasis added).

²⁰⁹ AICPA, *supra* note 14, at § 240.A1 (emphasis added); ISA 240, *supra* note 14, at A1 (emphasis added).

²¹⁰ SAS No. 99, *supra* note 183, at 106 ¶ 7 (emphasis added).

C. Who Originated the “Fraud Triangle” Name?

Even the origin of the term “fraud triangle” is disputed. Cressey did not use it in his writings.²¹¹ One source says that “Cressey[] . . . reputedly used the terminology in orally-delivered remarks,”²¹² but it does not provide a citation.²¹³ Morales et al. report that the AFCE stated in an email that Joseph Wells, its founder, originated the term with a triangle graphic he used in a “video featuring Dr. Cressey.”²¹⁴ However, Steve Albrecht, who used the term in a 1991 article,²¹⁵ has argued that he was the one who labelled the three factors the “fraud triangle,” after the “fire triangle,” when an attendee at a seminar Albrecht was giving at a paper company suggested that the two concepts are similar.²¹⁶

The label “fraud triangle” makes more sense when applied to Albrecht’s work than to Cressey’s. Cressey focused on embezzlement and similar trust violations,²¹⁷ while Albrecht and

²¹¹ Schuchter & Levi, *supra* note 156, at 177 n.5.

²¹² Ryesky, *supra* note 10, at 144 n.154.

²¹³ *See id.*

²¹⁴ *See* Morales et al., *supra* note 38, at 176. They explain:

We contacted the ACFE by email concerning the origins of this term and received the following response from an ACFE representative:

Dr. Cressey developed the three items, but he did not call it the Fraud Triangle. Actually, Dr. Joseph Wells is the first person we know of to take the three items and put [them] in a triangle format. He was working on a video featuring Dr. Cressey in 1985, and he used a triangle graphic in the video to illustrate the 3 factors that are present in most white-collar offenses. He began using the triangle graphic in training programs after that time. People saw the graphic and began referring to it as the Fraud Triangle over the years. So although we have never undertaken an extensive review of its use, as far as we know, that’s how it came about.

Id.

²¹⁵ W. Steve Albrecht, *Fraud in Government Entities: The Perpetrators and the Types of Fraud*, 7 GOV’T FIN. REV. 27, 27 (Dec. 1991).

²¹⁶ Albrecht, *supra* note 10, at 5. Albrecht adds, “I even included quotation marks around the term because I hadn’t heard it used before.” Albrecht, *supra* note 10, at 6.

The fire analogy may have caused some confusion. On the one hand, Albrecht wrote in 1991, “The fraud triangle is very much like the ‘fire triangle.’ In order to have a fire, three conditions must exist: there must be oxygen, heat and fuel. If any one of these is removed, there will be no fire. *Likewise with fraud: if either the pressure, opportunity or rationalization is removed, fraud does not occur.*” Albrecht, *supra* note 215, at 27 (emphasis added). This is consistent with Cressey’s argument. *See* CRESSEY, *supra* note 34, at 139 (“the absence of any of these [three] events will preclude violation.”). On the other hand, Albrecht and his co-authors of the 1979 study “found that the decision to commit fraud is determined by the interaction of all three forces,” Albrecht, *supra* note 10, at 5, such that if even if two elements are missing, fraud could occur if the other element is strong enough. *Id.* (stating, “[f]or example, fraud could theoretically occur under any situation if a person is motivated enough—even in the absence of outward opportunities or pressures.”). Schuchter and Levi found in interviews that it was not necessary for all three elements to be present, and they “strongly suggest that a distinction must be made” between the mechanisms of the fraud triangle and the fire triangle. Schuchter & Levi, *supra* note 155, at 109.

²¹⁷ *See* Huber, *supra* note 182, at 31 (arguing that the fraud triangle should be renamed the “embezzlement triangle” and that it has no application to fraud).

his co-authors studied the causes of fraud.²¹⁸ Morales et al. observe that “Cressey (1953) does not stress the word ‘fraud’ in his book; the index indicates only one page in which ‘fraudulent checks’ is found, while ‘embezzlement’ is found on 24 pages.”²¹⁹

Some sources refer to it as “Cressey’s fraud triangle”²²⁰ or say that Cressey developed the fraud triangle to explain the causes of fraud.²²¹ However, those sources miss the revisions the three Cressey factors underwent as they were adapted from the embezzlement context to the fraud context.²²²

III. APPLYING THE FRAUD TRIANGLE TO TAX EVASION

Although the fraud triangle was developed in the context of certain types of fraud, its three factors—(1) an incentive or perceived (usually financial) pressure, (2) perceived opportunity to cheat, and (3) rationalization of the planned action—could also apply to other kinds of fraud. For example, Lokanan and Sharma have applied it to the Libor-manipulation scandal.²²³ Albrecht has argued that the fraud triangle can apply to any kind of “compromise.”²²⁴

²¹⁸ See Albrecht, *supra* note 10, at 3 (stating that Cressey “never drew or referred to [the 3 elements] as a triangle nor used the term ‘fraud triangle.’ He also limited his discussion to embezzlement and not to fraud in general.”).

²¹⁹ Morales et al., *supra* note 38, at 176. However, an article published prior to his book and discussing some of the same material was called “Why Do Trusted Persons Commit Fraud?: A Social-Psychological Study of Defalcators.” See Cressey, *supra* note 49.

²²⁰ See, e.g., John D. Gill, *The Fraud Triangle On Trial*, 32 FRAUD MAG. 18, 19 (Sept./Oct. 2017), <https://www.fraud-magazine.com/article.aspx?id=4294999117> (stating in the abstract, “Dr. Donald Cressey’s Fraud Triangle has endured.”); P. Ravisankar et al., *Detection of financial statement fraud and feature selection using data mining techniques*, 50 DECISION SUPPORT SYS., 491, 492 (2011) (“The fraud triangle is also known as Cressey’s Triangle, or Cressey’s Fraud Triangle”).

²²¹ See, e.g., Rabi’u Abdullahi & Noorhayati Mansor, *Fraud Triangle Theory and Fraud Diamond Theory. Understanding the Convergent and Divergent For Future Research*, 5 INT’L J. OF ACAD. RES. IN ACC’TING, FIN. & MGMT. SCI. 38, 38 (Oct. 2015) (“Cressey (1950) focused his research on the factors that lead individuals to engage in fraudulent and unethical activity.”); Schuchter & Levi, *supra* note 155, at 107 (“This article revisits the Fraud Triangle, an explanatory framework for financial fraud, developed by the American criminologist Donald Cressey.”).

²²² See Gregory M. Trompeter et al., *A Synthesis of Fraud-Related Research*, 32 AUDITING: A J. OF PRAC. & THEORY 287, 291 (2013) (“Although initially developed by Cressey (1950) to explain embezzlement, researchers and regulators have expanded the fraud triangle model to incorporate fraudulent financial reporting. Consistent with this, they have broadened the language to include “pressure” and “incentive”).

²²³ See Lokanan & Sharma, *supra* note 26. For a description of the Libor scandal, see *Libor Scandal*, WIKIPEDIA, https://en.wikipedia.org/wiki/Libor_scandal.

²²⁴ Albrecht, *supra* note 10, at 6-7 (“Whether it’s fraud or any other type of compromise, the same three elements—perceived pressure, perceived opportunity and some way to rationalize the compromise as not being inconsistent with one’s code of conduct—are always present.”).

While there are questions about how far the fraud triangle can extend,²²⁵ applying it as a lens on tax evasion does not push the envelope very far. First, tax evasion is a type of fraud.²²⁶ Second, the fraud triangle often focuses on an individual acting alone, rather than collusive, organized activity.²²⁷ Tax evasion need not involve collusion. For example, it can occur in the context of an individual self-preparing an annual tax return or lying to a tax preparer.

Third, the origins of the fraud triangle lie in studies of embezzlers. CPAs Tackett et al. argued in an article in *Tax Notes* that “In most situations, tax evasion can be viewed as embezzlement of government funds. The fraud triangle is particularly applicable to embezzlement because Cressey’s original study used embezzlers as subjects.”²²⁸ Tax fraud is not identical to embezzlement, as the funds a taxpayer receives may begin as one’s own (e.g., as payment for services or property), rather than in trust for another party, but they share the aspect of conversion of funds that rightfully belong to another. Cressey actually used tax evasion as the opening example in an article focusing primarily on embezzlement.²²⁹ The fraud triangle has also evolved to encompass frauds that are further removed from embezzlement, such as financial statement fraud, which entails fraud on behalf of a third-party organization.

There does not appear to be a U.S. law review article applying the fraud triangle or fraud diamond to tax compliance or evasion. I found four articles discussing the fraud triangle in the tax evasion context, none of which is by lawyers or law professors.²³⁰ The most recent is a short article by three business school professors and a telematics professor applying the fraud triangle primarily to a specific tax evasion case.²³¹ Another is an article by three Australian accounting professors applying the fraud triangle to a set of Australian firms’ tax reporting to identify

²²⁵ See, e.g., Donegan & Ganon, *supra* note 179, at 3 (arguing that “even if Cressey’s findings for embezzlers were valid, there is little evidence to support the fraud triangle as a general theory of financial crime.”); *but cf. supra* Part I.A.4.b (discussing empirical studies applying the fraud triangle’s factors to financial fraud).

²²⁶ Emily Tuner et al., *A Historical View of the Walter Anderson Tax Evasion Scheme*, 128 J. TAX’N 7, 7 (2018) (“Fraud has often been described as the process of using dishonest methods to take, or misrepresent, something of value, often money or other resources, from another person or organization.. Under this definition, tax evasion is a particular type of fraud involving the illegal nonpayment or underpayment of tax.”); Doreen McBarnet, *Whiter Than White Collar Crime: Tax, Fraud Insurance and the Management of Stigma*, 42 BRITISH J.SOC., 323, 323 (Sep. 1991) (“Tax evasion is a term usually reserved for non-payment of tax by means of criminal fraud or other violations of law.”)

²²⁷ Free, *supra* note 7, at 185. Free observes that “the major frauds of recent decades, including Enron, WorldCom, Parmalat, HealthSouth and Satyam, all illustrate that collusion is a central element in many complex and costly frauds and financial crimes.” *Id.*

²²⁸ James A. Tackett et al., *A Criminological Perspective of Tax Evasion*, 110 TAX NOTES 654, 655 (2006).

²²⁹ See Cressey, *supra* note 48, at 13 (opening the article as follows: “Spring has returned, and with it two of the major themes of strategy in American life—how to win a baseball pennant and how to beat the income tax collector.”).

²³⁰ In addition, I recently authored a blog post applying the fraud triangle and fraud diamond to tax evasion. See Leandra Lederman, *Tax Evasion and the Fraud Diamond*, <https://surlysubgroup.com/2018/12/18/tax-evasion-and-the-fraud-diamond/>.

²³¹ Tuner et al., *supra* note 226, at 7.

badges of tax malfeasance.²³² There is also a survey article of tax evasion by two economics professors combining “Cressey’s (1953) ‘fraud triangle’ . . . with the Mazar et al. (2008) and Ariely (2012) approach which is called here ‘fudge triangle’.”²³³ The oldest one, by James A. Tackett et al., is a short article by three certified public accountants.²³⁴ That article engages in the most general application of the fraud triangle’s three factors to tax evasion. It is discussed in the next Section and critiqued further below.²³⁵

A. *The Three Factors*

In their *Tax Notes* article, Tackett et al. apply the fraud triangle to tax evasion element by element. They label the first element only as *pressure*—not incentive—and they explain that someone may feel financial pressure regarding the tax liability.²³⁶ They further argue that the costs of complying with the tax laws may cause psychological pressure and additional financial pressure.²³⁷ They briefly discuss the second element (*opportunity*), using a metaphor of a department store that functions on the honor system, implying, as discussed below,²³⁸ that lack of monitoring and punishment of transgressors would soon put the store out of business.²³⁹ With respect to the third factor (*rationalization*), Tackett et al. provide three possible types of rationalization for tax evasion.²⁴⁰ The discussion in Tackett et al. is brief. Each of the three elements of the fraud triangle has additional theoretical aspects, and is examined, in turn, below.

1. Financial Pressure or Incentive

In the embezzlement context, the embezzler typically deals with entrusted funds on a regular basis. A business owner with employees faces an analogous situation because of the requirement to withhold income and employment taxes from the employees’ paychecks and remit those taxes to the government.²⁴¹ Under the Internal Revenue Code, these taxes must be “held to be a special fund in trust for the United States.”²⁴² It is well known that struggling small businesses may fail to remit these “trust fund taxes” so as to avoid going out of business.²⁴³ This

²³² Grant Richardson et al., *Corporate Profiling of Tax-Malfeasance: A Theoretical and Empirical Assessment of Tax-Audited Australian Firms*, 12 *EJOURNAL OF TAX RES.* 359 (2014).

²³³ Michael Pickhardt & Aloys Prinz, *Behavioral Dynamics of Tax Evasion—A Survey*, 40 *J. ECON. PSYCH.* 1, 12 (2014).

²³⁴ Tackett et al., *supra* note 228, at 654.

²³⁵ See *infra* text accompanying notes 313-314.

²³⁶ Tackett et al., *supra* note 228, at 655.

²³⁷ *Id.*

²³⁸ See *infra* text accompanying notes 313-314 (critiquing the “honor system” metaphor).

²³⁹ Tackett et al., *supra* note 228, at 656 (discussing the “opportunity” element in two paragraphs, and referring to a department store operating on the honor system “without any supervision other than a 1 percent chance of being audited”; almost no likelihood of prosecution; and only a small fine if caught, and adding, “How long would such a store remain in business? The scenario is analogous to the federal income tax system.”).

²⁴⁰ See *id.* at 656.

²⁴¹ I.R.C. §§ 3101-3102 (FICA), 3402-3403 (withholding and payment of the taxes).

²⁴² I.R.C. § 7501(a).

²⁴³ See GENERAL ACCOUNTING OFFICE, TAX ADMINISTRATION: IRS’S EFFORTS TO IMPROVE COMPLIANCE WITH EMPLOYMENT TAX REQUIREMENTS SHOULD BE EVALUATED, GAO-02-92, 1 (Jan.

is closely analogous to embezzlement and similar violations of financial trust.²⁴⁴ The “financial pressure” element of the fraud triangle may help explain why a business owner could operate for a long time properly remitting trust funds taxes but begin to convert those funds for the business’s use when faced with financial difficulties that threaten the business’s existence.

Trust fund tax enforcement is distinct and carries a special tax penalty.²⁴⁵ A more well known situation for tax evasion involves an individual preparing an annual return, although some individuals also are required to make quarterly estimated tax payments.²⁴⁶ A taxpayer who owes tax but needs the money could be inclined to cheat so as to reduce the amount owed or produce a larger tax refund.

In the annual return-preparation context, even if the taxpayer faces no special external financial pressure, and even if the tax liability itself does not create pressure (e.g., because the taxpayer is due a tax refund), the possibility of being able to pocket extra money does create a financial incentive to cheat. The expansion in the traditional fraud context of the “pressure” element of Cressey’s research to the fraud triangle’s “pressure or incentive” thus helps increase the fit of the fraud triangle to the various contexts in which tax evasion may occur.

2. Opportunity to Evade

The second fraud triangle factor is “opportunity.” Tackett et al. remark that “[i]f opportunity is not present, fraud is impossible.”²⁴⁷ Morales et al. stated about Cressey’s concept of opportunity, “[o]f [Cressey’s] three conditions, the most evident (to the point where it may seem tautological) is that of perceived opportunity: if a person commits an act, then he or she

2002), at <http://www.gao.gov/new.items/d0292.pdf> (“[W]hen confronted with a choice between paying necessary operating expenses or depositing employment taxes, struggling businesses may opt to pay business expenses instead of taxes.”); ABA COMM. ON TAXPAYER COMPLIANCE, REPORT AND RECOMMENDATION ON TAXPAYER COMPLIANCE, 41 TAX LAW. 329, 367(1987) (“It is tempting for the business owner in such desperate straits to view employee tax withholdings as an interest-free loan that will be paid back once business turns around.”); T. Keith Fogg, *In Whom We Trust*, 43 CREIGHTON L. REV. 357, 361 (2010) (“Non-compliance with payment of collected taxes generally occurs with small businesses and not with large ones. . . . The failure rate of these businesses is high The federal tax obligation that impacts them most is the employment tax liability”); Lawrence J. Gregory, *Trust Fund Taxes: Personal Liability for Small Business Owners in Economic Decline*, 25 DCBA BRIEF 16, 17 (2012), <https://www.dcba.org/mpage/vol251112art1> (“A small business may be suffering for some time. . . . [O]wners may stop remitting employment tax withholding as a way to free up some extra cash, paying their suppliers instead.”).

²⁴⁴ Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 KAN. L. REV. 971, 1006-07 (2003) (“Often it is failing businesses that do not pay over the taxes, essentially embezzling them as a way to forestall closing down.”).

²⁴⁵ See I.R.C. § 6672(a) (“Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.”).

²⁴⁶ See IRS, DATA BOOK 2017 at 4, tbl. 2, <https://www.irs.gov/pub/irs-soi/17databk.pdf> (in 2017, 22,230,026 estimated income tax returns were filed).

²⁴⁷ Tackett et al., *supra* note 228, at 655.

must necessarily have perceived the possibility to do so.”²⁴⁸ The same holds for tax evasion. That is, tax evasion necessarily involves some kind of perceived opportunity to evade.

In the individual income tax context, some taxpayers have more opportunity to evade taxes than others. For example, it is easier to successfully evade taxes with respect to cash income than with respect to items that have a paper trail.²⁴⁹ Accordingly, the opportunity to evade can be constrained through the use of third-party withholding and/or information reporting.²⁵⁰

Withholding at source involves retention of a tax amount before it is ever paid to the taxpayer, decreasing the taxpayer’s opportunity to avoid paying it over²⁵¹ (but increasing the opportunity for the withholding agent to abscond with tax dollars).²⁵² Information reporting involves a paper trail that makes the payment visible to the tax authority: both the tax and the taxpayer receive an information report containing the amount paid and other information,

²⁴⁸ Morales et al. *supra* note 214, at 175; cf. Schucter & Levi, *supra* note 83, at 184 (“Contrary to findings in the literature and the previously mentioned international fraud standards, we found that only opportunity is (perhaps tautologically) mandatory for committing a white-collar crime, according to our interviewed offenders.”).

²⁴⁹ See, e.g., Dina Pomeranz, *No Taxation Without Information: Deterrence and Self-Enforcement in the Value Added Tax*, 105 AMER. ECON. REV. 2539, 2540 (2015) (finding evidence in a study of Chilean VAT enforcement that a paper trail deters tax evasion); Kathleen DeLaney Thomas, *User-Friendly Taxpaying*, 92 IND. L.J. 1509, 1534 (2017) (“the most obvious upside of information reporting is the clear deterrence benefit: income that is reported to the IRS by third parties is all but impossible for taxpayers to conceal without detection.”); Morse et al., *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL’Y REV. 37, 37 (2009) (“Underpayment of tax on business income is commonly attributed to the receipt of cash.”).

²⁵⁰ See generally Leandra Lederman & Joseph C. Dugan, *Information Matters in Tax Enforcement*, Indiana Legal Studies Research Paper No. 396 (2019), <https://ssrn.com/abstract=3325598>.

²⁵¹ The taxpayer whose taxes were withheld could still cheat on the tax return with respect to the income subject to withholding or with respect to other items. However, the paper trail accompanying the withheld amounts constrains cheating with respect to the item of income. IRS statistics show a 99% compliance rate with respect to items subject to information reporting and withholding (that is, wages and salaries). IRS, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2008–2010, at 12 tbl. 1 (2016), <https://www.irs.gov/pub/irs-soi/p1415.pdf>. With respect to other amounts, cash income generally faces the most evasion. A taxpayer with only wage income could invent deductions or credits, but those involve affirmatively including items on the return, rather than omitting an item. Taxpayers may be less likely to affirmatively lie than to lie by omission. See Jay A. Soled & Kathleen Delaney Thomas, *Regulating Tax Return Preparation*, 58 B.C. L. REV. 151, 196-97 (2017) (“As various psychological studies confirm, an act of omission (like failing to report income) costs individuals very little mental energy compared to an act of commission (like robbing a bank). . . . Forcing taxpayers to affirmatively lie on their return if they want to omit tax obligations should make them more reluctant to do so and thereby increase compliance.”) (footnotes omitted). Items listed on the return are also easier for the IRS to audit. See *Colony, Inc. v. Commissioner*, 357 U.S. 28, 36 (1958) (explaining, in the context of an extended statute of limitations, that “a taxpayer’s omission to report some taxable item [puts] the Commissioner is at a special disadvantage in detecting errors”).

²⁵² The withheld taxes constitute “trust fund taxes” that the withholding agent could fail to pay over. This issue is discussed in *supra* text accompanying notes 241-245.

including the amount of any tax withheld.²⁵³ The taxpayer could omit from the return the amount included in the information report, but simple document matching would likely detect it.²⁵⁴ That obvious transparency should deter tax evasion. And, in fact, IRS statistics support the intuitive notion that, as the information the IRS has about an income item decreases, voluntary compliance also decreases.²⁵⁵

Type of Income	Estimated Voluntary Compliance Rate
“Income subject to information reporting and withholding”	99%
“Income subject to substantial information reporting”	93%
“Income subject to some information reporting”	81%
“Income subject to little or no information reporting”	37%

The relationships among these figures have been very consistent over time.²⁵⁶ Although that does not prove causation, studies generally have found that information reporting increases reporting of income items.²⁵⁷ For example, after Congress enacted an information reporting requirement (Form 1099-K) for certain credit card payments, a study by Joel Slemrod et al. “estimate[d] that the introduction of the Form 1099-K prompted a 24% increase in reported

²⁵³ See Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 697 (2007). This also simplifies compliance for the taxpayer. Thomas, *supra* note 249, at 1534 (“An enormous advantage of information reporting for taxpayers is that it is essentially equivalent to recordkeeping by the third parties that report the income.”).

²⁵⁴ Jim Buttonow, *The New IRS “Audit”: Upfront Information-Statement Matching* (May 17, 2017), <https://www.hrblock.com/tax-center/newsroom/irs/upfront-information-statement-matching/>.

²⁵⁵ IRS, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2008–2010, at 12 tbl. 1 (2016), <https://www.irs.gov/pub/irs-soi/p1415.pdf>.

²⁵⁶ Compare, e.g., IRS, TAX GAP FOR TAX YEAR 2006, at 3 tbl. 1 (2012), https://www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf (showing estimated compliance rates for the categories in the chart that result in noncompliance rates of 99%, 92%, 89%, and 44%), with IRS, TAX YEAR 2001 INDIVIDUAL INCOME TAX UNDERREPORTING GAP, at 2 (2007), https://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf (showing noncompliance rates of 98.8%, 95.5%, 91.4%, and 46.1).

²⁵⁷ See, e.g., Todd Kumler et al., *Enlisting Employees in Improving Payroll-Tax Compliance: Evidence from Mexico* (NBER Working Paper No. 19385, 2013), <http://www.nber.org/papers/w19385.pdf> (finding that a pension reform in Mexico that linked younger workers’ pensions more closely to reported wages and gave those workers information to monitor reported wages reduced firms’ underreporting of wages and payroll tax evasion for younger workers); Joana Naritomi, *Consumers as Tax Auditors* (Working Paper, 2016), <https://www.researchgate.net/publication/303340924> (finding that the implementation in São Paulo, Brazil of a receipt lottery and online access for consumers to check the amount reported increased retailers’ reported revenues by at least 22 percent over four years); Junmin Wan, *The Incentive to Declare Taxes and Tax Revenue: The Lottery Receipt Experiment in China*, 14 REV. OF DEV. ECON. 611, 611 (2010) (finding that the introduction in certain provinces in China of a receipt lottery increased retailers’ sales tax payments in those provinces by 21.5%–24.2%).

receipts on average for [the subgroup of] firms reporting receipts exactly equal to the 1099-K amount.”²⁵⁸

Not surprisingly, the IRS is cognizant of the importance of the opportunity to evade tax.²⁵⁹ It has stated that “[f]or the individual income tax, reporting compliance is far higher when income items are subject to information reporting and even higher when also subject to withholding.”²⁶⁰

3. Rationalization

The fraud triangle’s third factor is “rationalization.” Cressey explained that:

[T]he potential trust violator . . . defines the relationship between the non-shareable problem and the illegal solution in language which enables him to look upon trust violation (a) as essentially non-criminal, (b) as justified, or (c) as a part of a general irresponsibility for which he is not completely accountable.²⁶¹

More recently, Vikas Anand et al. identified six rationalizations they “believe are most commonly used in organizations” as justifications for corrupt behavior:²⁶² (1) “Denial of responsibility” (“The actors engaged in corrupt behaviors perceive that they have no other choice than to participate in such activities”); (2) “Denial of injury” (“The actors are convinced that no one is harmed by their actions; hence the actions are not really corrupt.”); (3) “Denial of victim” (“The actors counter any blame for their actions by arguing that the violated party deserved whatever happened.”); (4) “Social weighting” (“The actors assume two practices that moderate the salience of corrupt behaviors: 1. Condemn the condemner, 2. Selective social comparison.”); (5) “Appeal to higher loyalties” (“The actors argue that their violation of norms is due to their attempt to realize a higher-order value.”); and (6) “Metaphor of the ledger” (“The actors rationalize that they are entitled to indulge in deviant behaviors because of their accrued credits (time and effort) in their jobs.”).²⁶³

Rationalizations can certainly come into play in the tax context. For example, the owner of a failing business who fails to pay over “trust fund taxes” could rationalize that this is the only way to save the business—which will help employees keep their jobs, and will give rise to

²⁵⁸ Joel Slemrod et al., *Does Credit-Card Information Reporting Improve Small-Business Tax Compliance?*, 149 J. PUB. ECON. 1, 18 (2017). This study also found that “this group of firms also increased reported expenses by 13%. This offsetting moderated the impact of 1099-K on total tax liability, even in groups strongly affected by 1099-K.” *Id.* at 18-19. Increasing deductions or credits is a way to continue to evade after an information-reporting requirement is added, but it is riskier than omitting cash income because the taxpayer must include deductions and credits on the tax return.

²⁵⁹ See IRS, *supra* note 255, at 11. (“The [voluntary compliance] estimates confirm the relationship between reporting compliance and third-party information reporting that was demonstrated in earlier tax gap estimates.”).

²⁶⁰ *Id.*

²⁶¹ CRESSEY, *supra* note 34, at 93.

²⁶² Vikas Anand et al., *Business As Usual: The Acceptance and Perpetuation of Corruption In Organizations*, 18 ACAD. OF MGMT. EXEC. 39, 41 (2004).

²⁶³ *Id.* at 41 tbl. 1.

increased tax payments in the future from both the employees and the business, once it is successful again. This is an example of “Appeal to higher loyalties” in the terminology of Anand et al.²⁶⁴ The owner could also rationalize that the nonpayment is only a “loan” that will soon be repaid.²⁶⁵ This is an example of “Denial of injury.”²⁶⁶

In the individual income tax context, Tackett et al. argue that “[t]he overwhelming rationalization used in tax evasion is the lack of equity in the tax system. The lack of equity rationalization manifests itself along three dimensions: uneven tax burden, fiscal irresponsibility by the government, and lack of enforcement.”²⁶⁷ That is, Tackett et al. argue that taxpayers may rationalize that (1) they are making up for tax breaks that others (e.g., the rich) get;²⁶⁸ (2) “governmental misspending or corruption justifies cheating on tax payments”;²⁶⁹ and (3) “[t]he lack of enforcement of the tax laws places an unfair burden on honest taxpayers.”²⁷⁰

The specific categories of rationalizations identified by Tackett et al. might be paraphrased as (1) *self-help* (creating one’s own tax break), (2) *an eye for an eye* (a response to perceived governmental misspending or other inadequacies), and (3) *refusal to be a chump* (because cheaters are routinely not caught, the compliant pay more than everyone else). The first type of rationalization focuses on the idea that others, particularly the rich, have access to tax shelters and tax breaks that the rationalizer does not. This type of rationalization may be fueled by stories about tax benefits available only to the high income or wealthy.²⁷¹ This appears to be an example of “Social weighting” in the terminology of Anand et al.²⁷²

The second type of rationalization—the eye-for-an-eye approach, which justifies evasion by pointing to government wastefulness or corruption—is a form of *quid pro quo*. In the typology of Anand et al., this falls within “Denial of victim”; Anand et al. give as an example justification for this one: “They deserved it.”²⁷³ This type of justification may be used by illegal tax protestors.²⁷⁴

²⁶⁴ See *id.* at 41 tbl. 1 (giving as example rationalization of this type, “We answered to a more important cause.”).

²⁶⁵ See ABA COMM. REPORT, *supra* note 243, at 367 (“It is tempting for the business owner in such desperate straits to view employee tax withholdings as an interest-free loan that will be paid back once business turns around.”).

²⁶⁶ See Anand et al., *supra* note 262, at 41 tbl. 1 (giving as example rationalization of this type, “No one was really harmed.”).

²⁶⁷ Tackett et al., *supra* note 228, at 656.

²⁶⁸ *Id.* at 656.

²⁶⁹ *Id.*

²⁷⁰ *Id.*

²⁷¹ For an example of this type of news story, see Emily Stewart, *America’s Getting \$10 Trillion In Tax Cuts, and 20% of Them Are Going The Richest 1%*, VOX (Jul. 11, 2018), <https://www.vox.com/policy-and-politics/2018/7/11/17560704/tax-cuts-rich-san-francisco-fed>.

²⁷² See Anand et al., *supra* note 262, at 41 tbl. 1 (giving as example rationalization of this type, “[o]thers are worse than we are.”).

²⁷³ *Id.*

²⁷⁴ See Danshera Cords, *Tax Protestors and Penalties: Ensuring Perceived Fairness and Mitigating Systemic Costs*, 2005 BRIGHAM YOUNG UNIV. L. REV. 1515 (“Individuals who are dissatisfied with the government and its policies are more likely to be convinced that the tax system is illegitimate than are individuals who are satisfied with the government and its policies.”).

The third form of rationalization is refusal to be the only “chump” who is honest. This may be a form of “Social weighting,”²⁷⁵ but it focuses on the zero-sum game aspect of taxpaying because tax evasion raises the tax cost for everyone else. The “chump” rationalization emphasizes the importance of enforcement to sustaining norms of tax compliance.²⁷⁶ Tackett et al. argue:

Many individuals believe (correctly) that tax evasion is widespread and goes unpunished in the vast majority of cases. The lack of enforcement of the tax laws places an unfair burden on honest taxpayers. Accordingly, tax evaders reason that evasion is their only option to obtain relief from an unjust tax system.²⁷⁷

In other words, regardless, non-enforcement “sends a signal . . . that others do not wish to enforce the tax laws and that tax evasion is in some sense socially acceptable, and the social norm of compliance disappears.”²⁷⁸

Taxpayers may use other rationalizations, as well. For example, they may rationalize that they need the money more than the government, that the government will never miss the money, or that they overpaid in a previous year and that this is a way to right that wrong.

B. The Fraud Diamond’s Added Factor: Capability

As noted above, the fraud diamond adds the fourth element of “capability” of perpetrating the fraud. Capability includes the skills to commit the crime as well as skills related to avoiding detection.²⁷⁹ Previous articles connecting the fraud triangle and tax evasion do not apply this fourth factor.²⁸⁰ Wolfe and Hermanson explain that

²⁷⁵ See Anand et al., *supra* note 262, at 41 tbl. 1.

²⁷⁶ See generally Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO STATE L.J. 1453 (2003) (synthesizing the experimental and empirical evidence and arguing tax enforcement buttresses tax compliance norms and can help tip a noncompliance norm in a community to a compliance norm); see also Lederman, *supra* note 3, at 658 (arguing that “[a] 2009 study of individuals from the neighboring countries of Botswana and South Africa supports the idea that enforcement efforts are more effective where compliance norms are stronger.”) (footnote omitted) (citing Ronald G. Cummings et al., *Tax Morale Affects Tax Compliance: Evidence From Surveys and an Artefactual Field Experiment*, 70 J. ECON. BEHAV & ORG. 447 (2009)).

²⁷⁷ Tackett et al., *supra* note 228, at 656.

²⁷⁸ James Alm & Jorge Martinez-Vazquez, *Institutions, Paradigms, and Tax Evasion in Developing and Transition Countries*, in PUBLIC FINANCE IN DEVELOPING AND TRANSITIONAL COUNTRIES 146, 151 (James Alm & Jorge Martinez-Vazquez eds., 2003) (adding that “Such an outcome is common in many countries, such as the Philippines and Italy”).

²⁷⁹ See *supra* text accompanying notes 114-115.

²⁸⁰ See Pickhardt & Prinz, *supra* note 233, at 12 (creating a “fudge triangle”); Richardson et al., *supra* note 232, at 361 (applying the fraud triangle to corporate tax malfeasance); Tackett et al., *supra* note 228, at 654-55 (“This study uses Donald R. Cressey’s ‘fraud triangle’ as an explanatory model of tax evasion.”); Tuner et al., *supra* note 226, at 7 (“To better understand tax evasion this article uses the fraud triangle from classical fraud theory to examine and better understand the case of Walter Anderson.”).

Opportunity opens the doorway to fraud, and incentive and rationalization can draw the person toward it. But the person must have the capability to recognize the open doorway as an opportunity and to take advantage of it by walking through, not just once, but time and time again. Accordingly, the critical question is, “Who could turn an opportunity for fraud into reality?”²⁸¹

They further provide the following example:

[C]onsider a company where the internal controls allow the possibility that revenues could be recorded prematurely by altering sales contract dates in the sales system. An opportunity for fraud exists, if the right person is in place to understand and exploit it. This opportunity for fraud becomes a much more serious problem if the company’s CEO, who is under intense pressure to increase sales, has the technical skills to understand that the control weakness exists, can coerce the CFO and sales manager to manipulate the sales contract dates, and can consistently lie to analysts and board members about the company’s growth. In the absence of such a CEO, the fraud possibility would never become reality, despite the presence of the elements of the fraud triangle. Thus, the CEO’s capabilities are a major factor in determining whether this control weakness will ultimately lead to fraud.²⁸²

Tax fraud does not involve that specific type of skill, but capability matters for tax evasion, too. The tax laws are complex, and some evasion is, as well. For example, evasion may involve keeping two sets of books,²⁸³ or setting up a web of offshore companies and complex transactions designed to hide the flow of funds.²⁸⁴

Some evasion may involve the assistance of a return preparer or other tax professional. In some instances, the preparer may be party to the fraud.²⁸⁵ In other instances, the preparer may innocently help the taxpayer. Grant Richardson et al. found in Australia that “firms who engage in [corporate social malfeasance] tend to so convolute their affairs that ‘big-4’ auditor involvement becomes a necessity.”²⁸⁶

²⁸¹ Wolfe & Hermanson, *supra* note 11, at 38.

²⁸² *Id.* at 39.

²⁸³ See Morse et al., *supra* note 249, at 60 (reporting that some “preparers were . . . involved in their clients’ tax evasion. The storekeeper quoted above is one taxpayer whose accountant helped him maintain a false set of books that will pass muster on audit . . .”).

²⁸⁴ See Leandra Lederman, *The Use of Voluntary Disclosure Initiatives in the Battles Against Offshore Tax Evasion*, 57 VILL. L. REV. 499, 500 (2012) (“Taxpayers who engage in intentional tax evasion typically do so by disguising their ownership of the offshore assets and failing to report on their tax returns ownership of the account or transactions in the account.”).

²⁸⁵ See Morse et al., *supra* note 249, at 62 (“Some interviewees, including both CPAs and business owners, reported that non-CPAs were more willing to actively assist their misreporting, but this observation was not uniform. . . . CPAs may have less of a tendency to actively assist a tax evasion strategy, but we found that some belong in the involved preparer category.”).

²⁸⁶ Grant Richardson et al., *Corporate Profiling of Tax-Malfeasance: A Theoretical and Empirical Assessment of Tax-Audited Australian Firms*, 12 EJOURNAL OF TAX RES. 359, 361 (2014).

By contrast, some evasion, such as intentionally failing to report cash income received, requires little capability. Moreover, for self-preparers, the fact that return-preparation software typically keeps a running total of the expected tax refund or payment due likely makes the mechanics of cheating easier, as someone can instantly see what effect an alteration in a particular number would have.²⁸⁷ Tax preparation software thus likely makes the “capability” factor a much lower bar. This raises both normative and software design issues. While a taxpayer’s easy access to tentative tax liability may have positive aspects, it may also mislead taxpayers by showing a running total that reflects incomplete information. An initial number that is erroneously high because it fails to reflect tax offsets that are entered later in the return-preparation process could also affect the taxpayer’s inclination to falsify subsequent inputs.

IV. IMPLICATIONS FOR THE DETERRENCE AND OTHER MODELS OF TAX COMPLIANCE

As noted at the beginning of this Article, the traditional economic model is the deterrence model, while, in recent years, scholars have considered behavioral explanations for compliance.²⁸⁸ Some scholars have pointed to the alleged inadequacy of the deterrence model as justifications for other explanations, such as “tax morale.”²⁸⁹

There is no reason that deterrence and behavioral factors can’t *both* positively influence tax compliance. Studies generally find that audits and audit threats have a strong positive effect on compliance,²⁹⁰ and that behavioral factors such as norms appeals²⁹¹ have at least some

²⁸⁷ Shaun Barry, *Gamifying Tax Preparation Is The Biggest Threat To The US Tax System* (Apr. 13, 2016), <https://blogs.sas.com/content/statelocalgov/2016/04/13/gamification-of-tax-evasion/>.

²⁸⁸ See *supra* text accompanying notes 2-5.

²⁸⁹ See, e.g., Cummings et al., *supra* note 276, at 449 (“extreme . . . risk aversion would be required to explain observed . . . compliance. Other factors must be at work.”); Frey, *supra* note 5, at 388-89 (2003) (seeking to “demonstrate that intrinsic motivation in the form of ‘tax morale’ is of substantial importance in explaining tax paying behavior.”); see also *id.* at 388 (arguing “that the deterrence model . . . is at best incomplete, and may even be wrong” and that tax morale is “the missing factor”); Bruno S. Frey & Lars P. Feld, *Deterrence and Morale in Taxation: An Empirical Analysis*, CESIFO WORKING PAPER NUMBER 760, 1, 8 (2002) (“[D]eterrence imposed by the tax authority, may undermine individuals’ intrinsic willingness to conform to tax laws. . .”).

²⁹⁰ See, e.g., Liucija Birskyte, *Effects of Tax Auditing: Does the Deterrent Deter?*, 8 RES. J. ECON., BUS. & ICT 1, 5 (2013) (finding that “[a] 1% increase in *federal* audit rate, on the average, increases individual income *state* tax collected per return by 1.74 dollars, holding other variables constant.”) (emphasis added); Henrik Jacobsen Kleven et al., *Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark*, 79 ECONOMETRICA 651, 689 (2011) (concluding in part that “[f]or self-reported income . . . tax evasion is substantial and responds negatively to an increase in the perceived probability of detection coming from either a prior audit or a threat-of-audit letter.”); cf. Dept. of the Treas.: Internal Revenue Service, in APPENDIX, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2016, at 1035, 1035, <https://www.gpo.gov/fdsys/pkg/BUDGET-2016-APP/pdf/BUDGET-2016-APP-1-19.pdf> (referring to “the indirect revenue effect of the deterrence value of [certain] enforcement investments, which is estimated to be at least three times the direct revenue impact”).

Studies generally find that penalties have a positive but smaller effect than audits on tax payments. See Lederman, *supra* note 3, at 660-66 (summarizing studies).

²⁹¹ See, e.g., Lucia Del Carpio, *Are the Neighbors Cheating? Evidence From a Social Norm Experiment on Property Taxes in Peru* 31 (Working Paper, Apr. 2014), https://faculty.insead.edu/lucia-del-carpio/documents/Are_the_neighbors_cheating_Apr2014.pdf (“Disclosing the true rate of (previous)

positive effect.²⁹² This Part argues that the fraud triangle’s framework can help bring together these differing theories or factors affecting tax compliance.

A. *The Deterrence Model and the Fraud Triangle*

As is well known in the tax compliance literature, under the deterrence model of tax compliance, the taxpayer compares the cost of compliance with the expected cost of noncompliance.

For example, a taxpayer who omits from income an amount resulting in understated tax of \$1,000 and who faces a 1 percent chance of audit that will detect the evasion and a 20% penalty in addition to the tax if detected (\$1,200 in total), faces an “expected” (probabilistic) cost of \$12.²⁹³

This compares to a cost of \$1,000 if the taxpayer fully complies with the tax laws with respect to the income in question. This model captures the probabilistic aspect of enforcement, and the example reflects realistic audit and penalty rates for the U.S. federal income tax system.²⁹⁴

compliance has a large significant positive impact on compliance (20% relative to the control group). The payment reminder, however, can explain almost half of this increase.”); Stephen Coleman, *The Minnesota Income Tax Compliance Experiment: State Tax Results*, Minnesota Department of Revenue 18 (Apr. 1996), https://www.revenue.state.mn.us/research_stats/research_reports/19xx/research_reports_content_complnce.pdf 9 (finding in a study of Minnesota taxpayers that “Letter 2 [the norms letter] . . . had a moderately significant effect on the entire sample and a stronger effect within a large subgroup of taxpayers”); Wenzel, *supra* note 318, at 877-78 (“When taxpayers were informed about the inconsistency between their own tax ethics and those attributed to other people, they claimed fewer non-WRE [work-related expense] deductions compared to taxpayers who had not received that information. However, no effect emerged for WRE claims, even though survey questions and feedback intervention explicitly referred to these.”); *but cf.* Marsha Blumenthal et al., *The Determinants of Income Tax Compliance: Evidence from a Controlled Experiment in Minnesota*, 54 NAT’L TAX J. 125, 132 (2001) (describing “(Letter2: Join the Compliant Majority)” (not finding a statistically significant effect in a study using the same Minnesota data as Coleman).

²⁹² Other behavioral factors may have an effect, as well. For example, there are several studies examining the effect of procedural fairness or procedural justice on tax compliance. *See, e.g.*, Martina Hartner et al., *Procedural Fairness and Tax Compliance*, 38 ECON. ANAL. & POL’Y 137, 149-50 (2008) (“Overall, and despite the limitations of the findings in terms of extrapolatibility, the analysis shows a clear direct effect of procedural justice on motivational postures with all three samples.”); Kristina Murphy, *Procedural Justice and Tax Compliance*, 38 AUSTRALIAN J. OF SOC. ISSUES 379, 384 (2003) (studying “why the majority of [certain tax] scheme investors reacted in such a negative way to the ATO’s [(Australian Taxation Office’s)] handling of the issue”); Michael Wenzel, *The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers’ Identity*, 87 J. OF APPLIED PSYCH. 629, 639 (2002) (finding that “[n]oncompliance with regard to income reporting and tax minimization was exclusively predicted by self-interest variables, whereas noncompliance in reporting of extra income as well as deduction claims was additionally influenced by identification and, interacting with identification, perceptions of justice.”).

²⁹³ Lederman, *supra* note 3, at 647. The math is as follows: $.01 * (\$1000 + [20\% * \$1,000])$.

²⁹⁴ The standard U.S. federal tax penalty is 20 percent of the understated tax, on top of the tax due. I.R.C. § 6662(a), (b) (imposing a 20% penalty for such things as negligence or substantial understatement of tax); *cf.* § 6663(a) (“If any part of any underpayment of tax required to be shown on a

1. The Fraud Triangle’s “Incentive or Pressure” Prong

Recall that the first prong of the fraud triangle is *incentive or pressure*.²⁹⁵ Incentive is an economic notion, so it fits very well with the deterrence model. The possibility of paying less to the government provides an incentive to cheat on one’s taxes. That is true regardless of whether a taxpayer faces financial pressures, although such pressures could increase the incentive to cheat. Thus, the first prong of the fraud triangle is consistent with economic analysis of the tax compliance decision.

2. The Fraud Triangle’s “Opportunity” Prong

Note that under the basic economic model, at the realistic audit and penalty levels reflected in the example, evasion appears much less costly than compliance, implying that the taxpayer would always choose evasion. Thus, the deterrence model would seem to predict *zero* compliance. Yet, we observe positive and even high compliance rates in the real world. For example, the IRS estimates an overall voluntary compliance rate of 81.7 percent with legal-source income.²⁹⁶ Economists framed this as the “puzzle” of tax compliance,²⁹⁷ and numerous scholars have concluded based on this superficial comparison that the deterrence model is

return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.”). The IRS reports audit rates for U.S. individuals and corporations of around 1 percent. *See* IRS, DATA BOOK 2017 23 tbl.9a, <https://www.irs.gov/pub/irs-soi/17databk.pdf> (0.6% of individual tax returns and 1.0% of corporate returns were examined by the IRS for fiscal year (FY) 2017).

²⁹⁵ *See supra* text accompanying note 14.

²⁹⁶ IRS, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2008–2010, at 7 (2016), <https://www.irs.gov/pub/irs-soi/p1415.pdf>.

²⁹⁷ *See, e.g.*, James Alm et al., *Economic and Noneconomic Factors in Tax Compliance*, 48 KYKLOS 3, 3 (1995) (the puzzle of tax compliance is not so much ‘Why is there so *much* cheating?’ Instead, the real puzzle is ‘Why is there so *little* cheating?’); Lars P. Feld & Bruno Frey, *Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation*, 29 L. & POL’Y 102, 102 (2007) (“The puzzle of the economic theory of tax compliance is why people pay taxes.”); J.T. Manhire, *There Is No Spoon: Reconsidering the Tax Compliance Puzzle*, 17 FLA. TAX REV. 623, 630 (2015) (“[H]ow does one explain the relatively high voluntary compliance rate given the relatively low audit rate in the United States? This apparent difficulty is sometimes referred to as the ‘tax compliance puzzle.’”); Benno Torgler & Friedrich Schneider, *The Impact of Tax Morale and Institutional Quality on the Shadow Economy*, 30 J.ECON. PSYCHOL. 228, 230 (stating that “in many countries, the level of deterrence is too low to explain the high degree of tax compliance” and referring to the “puzzle of tax compliance”).

incorrect.²⁹⁸ Some scholars have used that to justify advancing other theories of tax compliance, such as “tax morale,”²⁹⁹ which is discussed below.³⁰⁰

Yet, this purported compliance “puzzle” ignores (among other things)³⁰¹ the issue of opportunity to evade.³⁰² That is, simply comparing (relatively) low audit rates and penalties with (relatively) high compliance rates assumes that taxpayers have an open opportunity to cheat with respect to all items on the tax return—but that is not the case. There are at least two important

²⁹⁸ See, e.g., Frey, *supra* note 5, at 388 (“There is compelling evidence that the deterrence model, and therewith tax policy based on deterrence, is at best incomplete, and may even be wrong.”); MARC LEROY, L’IMPÔT, L’ÉTAT ET LA SOCIÉTÉ 241 (2010) (“Concernant le risque du contrôle fiscal, un fait important est que la fréquence moyenne de vérifications est en générale faible, et donc que le respect des obligations déclaratives devrait être plus faible qu’il n’est : cette observation contredit l’approche par la maximization de l’utilité.” (meaning “With respect to tax enforcement, an important fact is that the average audit rate generally is low, and so voluntary tax compliance should be lower than it actually is; this observation contradicts the utility-maximization approach.”)); J. Manhire, *Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance Models*, 33 VA. TAX REV. 629, 629 (2014) (“The classic deterrence theory model of income tax evasion first articulated in 1972 has met significant criticism because it does not comport with the observed rate of tax compliance.”); Eric Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1782 (2000) (“A widespread view among tax scholars holds that law enforcement does not explain why people pay taxes.”).

²⁹⁹ See, e.g., Frey, *supra* note 5, at 389 (“It has been well established that taxpaying behaviour cannot be explained in a satisfactory way without taking tax morale into account.”); Richard Lavoie, *Flying Above the Law and Below the Radar: Instilling a Taxpaying Ethos in Those Playing by Their Own Rules*, 29 PACE L. REV. 637, 642 (2009) (“[b]ecause the deterrence model fails to accurately predict tax evasion levels, other forces must be influencing citizens to comply despite the apparently overwhelming economic utility of cheating. The hodgepodge of non-coercive forces and behavioral traits that influence the degree of tax evasion are generally referred to under the umbrella rubric of a society’s ‘tax morale.’”); Kornhauser, *supra* note 5, at 602-03 (2007) (“The key to the [tax compliance] puzzle is ‘tax morale,’ the collective name for all the non-rational factors and motivations—such as social norms, personal values and various cognitive processes—that strongly affect an individual’s voluntary compliance with laws.”); cf. Posner, *supra* note 298, at 1782 (stating that “[a] widespread view among tax scholars holds that law enforcement does not explain why people pay taxes” and advocating for a signaling model of tax compliance).

³⁰⁰ See *infra* text accompanying notes 343-351.

³⁰¹ See Lederman, *supra* note 3, at 656-58 (summarizing factors missing from the basic deterrence model, including criminal penalties and the hassle of undergoing an audit).

³⁰² See, e.g., Henrik Jacobsen Kleven et al., *Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark*, 79 ECONOMETRICA 651, 653 (2011) (“[O]ur findings suggest that tax evasion is low, not because taxpayers are unwilling to cheat, but because they are unable to cheat successfully due to the widespread use of third-party reporting.”); Lederman, *supra* note 3, at 651 (“While there is certainly room for civic commitments and respect for the law as explanations for some compliance, the lack of opportunity for tax evasion . . . explains much tax compliance and is consistent with the deterrence model.”); Lederman, *supra* note 253, at 697 (“An essential missing piece of this seeming puzzle is that the federal income tax law benefits from structural mechanisms that constrain payment with respect to the major sources of income for many people, including wages and salaries.”); Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 37 (2007) (“Line item by line item, there is a clear positive correlation between the rate of compliance and the presence of enforcement mechanisms such as information reports and employer withholding.”).

ways in which the government restricts the opportunity to evade taxes. One involves a “structural system” and the other involves monitoring that is not included in audit statistics.

A structural system is a built-in constraint that channels behavior. For example, a speed limit sign informs drivers of the speed limit but is not self-enforcing. It typically requires police to enforce it. By contrast, a road can be structured to reduce speeding, such as by installing a speed bump.³⁰³ The speed bump is a form of structural deterrent.

Because structural systems impose constraints on behavior, they should require much less monitoring for compliance than does a law or rule without a constraining structure. In the tax law, withholding serves as a structural system.³⁰⁴ This system involves a third party (typically someone who at arm’s length from the taxpayer), rather than a physical feature such as a speed bump, but it still helps to constrain the taxpayer’s compliance. The IRS estimates timely and voluntary tax payment with respect to income subject to withholding at 99%.³⁰⁵

Absent a structural feature, enforcement typically relies on monitoring to deter violations. In the driving context, that often involves police officers. However, law enforcement can also use monitoring devices such as radar or cameras to detect evaders.³⁰⁶

In the tax context, some monitoring is not included in audit statistics.³⁰⁷ That includes some IRS contacts with the taxpayer.³⁰⁸ It also includes third-party information reporting. Such third-party reporting is analogous to a technology such as a camera: it informs the government of the individual’s behavior, typically while also informing the individual that the government is watching.³⁰⁹ Thus, a taxpayer who receives \$1,000 of interest or dividend or salary income generally cannot omit it and face a mere 1% chance of detection because information reporting (and possibly withholding) make the payment transparent to the IRS. “Information returning

³⁰³ See Lederman, *supra* note 253, at 696 (“[I]f the government seeks to reduce speeding in a residential neighborhood, instead of (or in addition to) imposing fines and ticketing speeders, it can construct roads in ways that help reduce speeding, such as making them narrow or winding, or including speed bumps.”) (footnote omitted).

³⁰⁴ *Id.* at 697.

³⁰⁵ See *supra* text accompanying note 255.

³⁰⁶ See Lederman, *supra* note 253, at 696 (discussing red-light cameras).

³⁰⁷ The National Taxpayer Advocate has explained:

The IRS has several . . . types of compliance contacts with taxpayers that it does not consider to be “real” audits. These types of contacts, which I call “unreal” audits, include math error corrections, Automated Underreporter (AUR) (a document matching program), identity and wage verification, and Automated Substitute for Return (ASFR) (a non-filer program). . . . In fiscal year 2016 . . . the IRS conducted slightly more than a million “real” audits, resulting in an audit rate of 0.7 percent. However, during the same timeframe, the IRS conducted approximately 8.5 million “unreal” audits. When adding these “unreal” audit numbers to the “real” ones, the IRS’s combined coverage rate jumps to over six percent.

NTA Blog, “*Real*” vs. “*Unreal*” Audits and Why This Distinction Matters, TAXPAYER ADVOC. SERV. (July 6, 2018), <https://taxpayeradvocate.irs.gov/news/nta-blog-real-vs-unreal-audits-and-why-this-distinction-matters>.

³⁰⁸ *Id.*

³⁰⁹ See Lederman, *supra* note 253, at 696.

matching can be viewed as an invisible audit—but it is not counted in audit rate statistics.”³¹⁰ The IRS estimates timely and voluntary tax payment with respect to income subject to complete third-party information reporting (but not withholding) at 93%.³¹¹

The fraud triangle’s second factor is *opportunity*. Accordingly, it underscores the importance to the analysis of opportunity to commit fraud—which, in the tax context, is opportunity to evade. As discussed above, opportunity is a critical factor, because without an opening, fraudulent actions cannot take place.³¹² But opportunity is of course not the *only* element in either the fraud triangle or in tax evasion.

Tackett et al. provide the following analogy in their discussion of the application of the fraud triangle’s “opportunity” element to tax evasion:

Suppose a department store operated on the honor system, in which customers selected merchandise, tallied their bill, and remitted their payment without any supervision other than a 1 percent chance of being audited. Assume further that customers who are caught cheating are almost never prosecuted, but merely have to pay the accurate amount of their purchase along with a modest financial penalty. How long would such a store remain in business? The scenario is analogous to the federal income tax system.³¹³

This is an interesting analogy, but it reflects the same trap that scholars who only look at audits and penalties when evaluating the deterrence model fall into: it is apt only for amounts not subject to third-party reporting. Imagine if Tackett et al.’s hypothetical store also had a department with all of its merchandise in locked cases, where a salesperson had to take the merchandise and an invoice to a cashier to await customer payment. That department would no doubt experience much less nonpayment, just as items subject to third-party information reporting do.³¹⁴ The locked case is a structural system, analogous to withholding, and the accompanying person essentially provides information reporting.

Thus, two of the three fraud triangle factors align nicely with the deterrence model of tax compliance. The third factor, *rationalization*, fits better with behavioral theories of tax compliance, as discussed in the next Section.

B. Behavioral Approaches to Tax Compliance and the Fraud Triangle’s “Rationalization” Prong

While enforcement has been shown empirically to positively affect tax compliance,³¹⁵ it is not the only thing that does. Behavioral factors do as well. As a simple example, risk aversion is a behavioral factor that is often discussed in connection with the basic economic model of tax

³¹⁰ Lederman, *supra* note 244, at 975.

³¹¹ See *supra* text accompanying note 255.

³¹² See *supra* text accompanying notes 247-248.

³¹³ Tackett et al., *supra* note 228, at 656.

³¹⁴ See *supra* text accompanying note 255.

³¹⁵ See *supra* note 290.

compliance.³¹⁶ This example also shows that a behavioral element need not be considered inconsistent with economic modeling of tax compliance. Risk aversion increases deterrence under the basic economic model.³¹⁷

Thus, considering a prong of the fraud triangle other than the two discussed above in connection with the deterrence model—*incentive or pressure* and *opportunity*—does not undermine those two prongs. The fraud triangle’s third factor, *rationalization*, is focused on the psychological aspects of the violation and thus fits well with behavioral theories. This Section focuses on two frequently discussed behavioral theories, social norms and tax morale, to show how the rationalization prong of the fraud triangle sheds light on them.

1. Norms of Compliance or Noncompliance

Several scholars have studied the effects on tax compliance of normative appeals.³¹⁸ Such appeals generally take the form of a letter from the tax authority touting the community’s high level of compliance.³¹⁹ As noted above, some studies show that appeals to compliance norms may have at least a modest positive effect on tax payments.³²⁰ The converse is that community norms of noncompliance may foster noncompliance.³²¹

The fraud triangle’s *rationalization* prong focuses on the psychology of the offender. Cressey explained that rationalization, in the sense in which he used the term, can “refer to a process of finding some logical excuse for questionable behavior tendencies, for thoughts as well

³¹⁶ See, e.g., Allingham & Sandmo, *supra* note 2, at 327 (including risk aversion in an original economic model of tax compliance); James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818, 823 (1998) (including taxpayer risk aversion in a basic economic model of compliance).

³¹⁷ Allingham & Sandmo, *supra* note 2, at 329 (“when actual income varies, the fraction declared increases, stays constant or decreases . . . as relative risk aversion is an increasing, constant or decreasing function of income.”).

³¹⁸ See, e.g., Blumenthal et al., *supra* note 291, at 129 (describing “(Letter2: Join the Compliant Majority”); John Hasseldine et al., *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 CONTEMP. ACCT. RES. 171, 178 (2007) (reporting on a study that included in one letter both a norms-based appeal and moral suasion); Michael Wenzel, *Misperceptions of Social Norms About Tax Compliance: From Theory To Intervention*, 26 J. ECON. PSYCH. 862, 871 (2005) (surveying taxpayers and reporting survey results in a letter).

³¹⁹ See, e.g., Blumenthal et al., *supra* note 291, at 129 (“The middle paragraph [of Letter 2] stated that IRS audits show that ‘people who file tax returns report correctly and pay voluntarily 93 percent of the income taxes they owe.’ It concluded, ‘Although some taxpayers owe money because of minor errors, a small number of taxpayers who deliberately cheat owe the bulk of unpaid taxes.’”); Wenzel, *supra* note 318, at 874 (letter to taxpayers stated in part, “These [survey] results indicate that we tend to think most people accept tax cheating and exaggerations in tax deductions. However, the truth is that most people think we should be honest with our tax statements and claim only those deductions that are allowable.”); cf. Hasseldine et al., *supra* note 318, at 178 (describing letter combining elements of a normative appeal and moral suasion).

³²⁰ See *supra* note 291 and accompanying text.

³²¹ See Lederman, *supra* note 4, at 1469-70 (noting the possibility that “observing others’ noncompliance might change the observer’s moral standard so that he or she might feel less guilt in failing to comply.”).

as acts, and for decisions to perform an act.”³²² Thus, rationalization allows the offender to mentally justify his or her actions, so as to minimize cognitive dissonance between his or her self-image as an honest person and the fraudulent action.³²³

Community norms of compliance may make it harder for a taxpayer to justify evasion on the basis of bandwagon-type rationalizations such as “everyone does it” or neutralizations³²⁴ such as “it’s not really wrong.” By contrast, norms of noncompliance may facilitate rationalizations that the violation is not really a crime, or not so bad, or required so as not to be the only chump paying full freight.³²⁵ Thus, community norms may hinder or facilitate rationalizations that help a taxpayer justify evasion.

Enforcement may also help foster compliance norms,³²⁶ perhaps because it signals that violators are punished.³²⁷ One study suggests that enforcement may even be more effective where compliance norms are stronger.³²⁸ The fraud triangle framework supports that idea because it is harder to rationalize that one’s behavior is not illegal or does not matter to the government if the government is visibly enforcing the law.

2. Taxpayer Views of Government

Some taxpayers may use claimed government failures to justify tax noncompliance.³²⁹ For example, they may object to how tax revenues are spent. They may refuse to pay tax, or

³²² CRESSEY, *supra* note 34, at 94.

³²³ See *supra* text accompanying note 72.

³²⁴ See Gresham M. Sykes & David Matza, *Techniques of Neutralization: A Theory of Delinquency*, 22 AM. SOC. REV. 664, 667 (Dec. 1957) (“[T]he delinquent represents not a radical opposition to law-abiding society but something more like an apologetic failure, often more sinned against than sinning in his own eyes. We call these justifications of deviant behavior techniques of neutralization . . .”).

³²⁵ See *supra* text accompanying notes 275-278 (discussing these rationalizations).

³²⁶ See Del Carpio, *supra* note 320, at 21 (finding that “after the municipal enforcement policy begins . . . the effect of the norms treatment relative to the payment reminder increases almost two-fold (columns 5 and 6 in Table 6), and the difference between the two is marginally significant ($p = 15\%$)” and arguing that this “points to an interesting complementarity between the norms treatment and the standard enforcement policy.”);

³²⁷ See John T. Scholz, *Contractual Compliance and the Federal Income Tax System*, 13 WASH. U. J. L. & POL’Y 139, 192 (2003) (arguing that, under his contractarian model of tax compliance, “the critical function of the state’s tax enforcement power is to assure adaptive contractarians that other citizens will meet their contractual obligations, assuring the adaptive contractarian that he or she is not foolish in meeting these same obligations.”); see also Lederman, *supra* note 4, at 1499 (arguing, based on experimental evidence, that “[e]nforcement may therefore have the effect of deterring some people and increasing the robustness of a compliance norm for others by minimizing their exposure to tax evasion.”).

³²⁸ See Cummings et al., *supra* note 276, at 448 (stating that “while compliance does increase with enforcement effort, the effect is less in the country for which governance is less good”—Botswana); Lederman, *supra* note 3, at 658-59 (arguing that the study’s results show greater normative commitments to tax compliance in Botswana than the comparator country, South Africa).

³²⁹ See *supra* note 274 and accompanying text (mentioning tax protestors).

certain taxes, until government policies change.³³⁰ In a 1991 article, Kent Smith and Loretta Stalans listed three categories of people who “account for the majority of noncompliance with tax laws.”³³¹ The third category was “those who willfully engage in tax noncompliance because they perceive that their tax dollars are not being spent appropriately or that government authorities are not treating them or other taxpayers appropriately.”³³²

One way to view the taxpayer-government relationship is as a type of contract. For example, political scientist John T. Scholz has advanced a “contractarian” theory of tax compliance under which taxpayers factor in the government’s provision of public goods.³³³ Swiss economists Lars Feld and Bruno Frey have referred to a “psychological tax contract” between taxpayers and the government³³⁴ Feld and Frey argued that “a steady reduction in tax compliance need not only be interpreted as a violation of the law, but also as taxpayers’ discontent with what they receive for their taxes.”³³⁵

Others have different views. For example, Joshua Rosenberg has argued that the payment of taxes and the receipt of benefits are not very linked in most taxpayers’ minds, due to “the separation of the burdens of tax from the benefits of government.”³³⁶ Moreover, “the benefits of taxes (that is, the receipt of government services) seem both small and unrelated to our actual tax payments. As the benefits of tax fade from consciousness, and as their burdens grow in prominence, we begin to perceive the taxes themselves as little more than undeserved and unduly painful punishments.”³³⁷ Studies generally have not found a significant effect on tax payments of letters to taxpayers that focus on the public goods the government provides.³³⁸

³³⁰ See Michael McKee, *Fiscal Exchange, Collective Institutions, and Tax Compliance*, 22 J. ECON. BEHAV. & ORG. 285, 285 (1993).

³³¹ Kent W. Smith & Loretta J. Stalans, *Encouraging Tax Compliance With Positive Incentives: A Conceptual Framework and Research Directions*, 13 L. & POL’Y 35, 36 (1991).

³³² *Id.* The other two categories they identified were (1) subcultures where tax cheating is the norm, and (2) those making careless errors. *Id.*

³³³ See Scholz, *supra* note 327, at 139.

³³⁴ Feld & Frey, *supra* note 297, at 106 (“In the psychological tax contract, punishment still plays a role in order to provide deterrence. But the satisfaction of taxpayers with what they get from the other contract party, that is, the government, mainly influences their tax morale.”).

³³⁵ *Id.* at 107.

³³⁶ Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane*, 16 VA. TAX REV. 155, 171 (1996).

³³⁷ *Id.*

³³⁸ See, e.g., Barak Ariel, *Deterrence and Moral Persuasion Effects on Corporate Tax Compliance: Findings from a Randomized Controlled Trial*, 50 AM. J. CRIM. 27, 41–45, 58 (2012) (finding that a letter to Israeli corporations explaining how tax dollars were allocated, providing reasons for paying taxes, and highlighting the societal harm from not paying, resulted in a small but statistically significant effect in the direction of noncompliance with a Value Added Tax (VAT)); Blumenthal et al., *supra* note 291, at 131-32 (finding no statistically significant effects of a “Support Valuable Services” letter); Benno Torgler, *Moral Suasion: An Alternative Tax Policy Strategy? Evidence from a Controlled Field Experiment in Switzerland*, 5 ECON. GOV. 235, 239–40, 249–50 (2004) (finding an insignificant effect on timely filing and payment in Trimbach, Switzerland, of a letter stating, “[i]f the taxpayers did not contribute their share, our commune with its 6226 inhabitants would suffer greatly. With your taxes you help keep Trimbach attractive for its inhabitants.”) (emphasis omitted). *But cf.* Michael Chirico et al., *An Experimental Evaluation of Notification Strategies to Increase Property Tax Compliance: Free-Riding*

While a decline in tax compliance could have many causes, including a reduction in the audit rate,³³⁹ taxpayer claims that they are protesting government wrongs could suggest that “good government” measures would foster compliance. Feld and Frey argue that “[t]he[] bonds between taxpayers and the state represent the core of individual tax morale, and thus positively affect tax compliance.”³⁴⁰ Appropriate treatment of the citizenry should certainly be a government priority, but whether it results in increased tax compliance is an empirical question. Different reforms may have different effects. For example, previous work found that there is some evidence that procedural fairness on the part of the tax collector increases tax payments,³⁴¹ but that there was no evidence that increased service by the tax collector did so.³⁴²

As noted above, Swiss economist Bruno Frey and other scholars have argued that “tax morale” is central to tax compliance.³⁴³ This term is generally used to refer to all intrinsic motivations to pay taxes.³⁴⁴ It contrasts with deterrence, which involves the extrinsic motivators of audits and penalties.³⁴⁵ Frey has pointed to trust in government as the principal source of tax morale, arguing that “[t]ax morale must be put in the general context of the relationship between citizen and the state: At the one extreme, there are exploitative governments ruling their people in an authoritarian or even dictatorial way. . . . At the other extreme, there are participatory governments in which the taxpayers as citizens can themselves determine for what purposes the revenues should be used.”³⁴⁶

in the City of Brotherly Love, in 30 TAX POL’Y & ECON. 129, 146 tbl.5 (Jeffrey R. Brown, ed.) (2016), http://www.nber.org/chapters/c13_690.pdf (finding that a letter describing public services had a statistically significant effect at $p < .05$ on the subgroup of single-property owners).

³³⁹ See Lederman, *supra* note 3, at 700 (concluding, based on a synthesis of studies, that “at low audit rates such as those in the United States, the evidence suggests that increasing the audit rate would increase overall tax compliance.”).

³⁴⁰ Feld & Frey, *supra* note 297, at 103.

³⁴¹ See Lederman, *supra* note 244, at 996-1004 (synthesizing then-existing studies); *supra* note 292 (citing additional studies).

³⁴² See Lederman, *supra* note 244, at 993-96 (synthesizing then-existing studies).

³⁴³ See *supra* note 289 and accompanying text.

³⁴⁴ See, e.g., Feld & Frey, *supra* note 5, at 88 (“the existence of an intrinsic motivation to pay taxes . . . has sometimes been called ‘tax morale.’”); Frey, *supra* note 5, at 388–89 (arguing “that intrinsic motivation in the form of ‘tax morale’ is of substantial importance in explaining tax paying behavior.”).

³⁴⁵ See Torgler, *supra* note 338, at 236 (“When monitoring and penalties for noncompliance are intensified, individuals notice that extrinsic motivation has increased . . .”).

³⁴⁶ Frey, *supra* note 5, at 389-90; Bruno S. Frey, *Punishment—and Beyond*, 5 CONTEMP. ECON. 90, 92 (2011) (“An unfair, inconsiderate way of treating taxpayers—punishing honest taxpayers by error—tends to undermine this tax morale.”); Bruno S. Frey & Benno Torgler, *Tax Morale and Conditional Cooperation*, 35 J. COMP. ECON., 136, 144 (2007) (“If taxpayers think they are in a better position to monitor and control politicians, their willingness to cooperate and pay taxes increases. Therefore, a higher degree of satisfaction with a country’s democratic institution should lead to higher tax morale.”); Feld & Frey *supra* note 297, at 103 (“For that contract to be upheld, incentives like rewards or punishment need to be provided, but loyalties and emotional ties that go well beyond transactional exchanges must be considered additionally. These bonds between taxpayers and the state represent the core of individual tax morale and thus positively affect tax compliance.”).

While deterrence and behavioral theories of tax compliance can co-exist,³⁴⁷ proponents of tax morale often state that deterrence, with its focus on extrinsic motivators, may “crowd out” voluntary inclinations to comply, even to the point of increasing noncompliance.³⁴⁸ For example, Swiss economist Bruno Frey has argued that “deterrence imposed by the tax authority may crowd out individuals’ intrinsic willingness to conform to tax laws. Tax morale may be undermined.”³⁴⁹ Similarly, Feld and Frey argued that “[t]wo opposite cases of treating taxpayers can be distinguished: (1) respectful treatment supporting, and possibly raising, tax morale; and (2) authoritarian treatment undermining tax morale.”³⁵⁰ However, there is little evidence that deterrence has a crowding-out effect that reduces voluntary compliance.³⁵¹ Instead, there is strong evidence that deterrence, particularly the threat of audit, is very effective at increasing tax payments.³⁵²

The lens of the fraud triangle suggests that a view that the government or tax system is unjust or inequitable may be part of the *rationalization* prong for some people. That is, it may allow people to justify not complying with tax obligations. Joshua Rosenberg has argued:

At least a part of the reason we do not comply more fully with the tax laws is that we believe either taxes specifically, or government in general, is unfair. *Also true, however, is exactly the opposite: an important reason we believe tax laws are unfair is that we do not comply more fully with those laws.*³⁵³

He explains the psychology as an approach to avoid cognitive dissonance:

Individuals are most comfortable when they act in ways consistent with a sense of themselves as basically good, law-abiding citizens. For tax-evaders, the notion that they are stealing from the government just because they think they can get away with it is inconsistent with that self-image. In order to allow themselves to maintain a positive sense of self, the “rational” part of their minds develops an understanding of what they are doing and why they are doing it that allows them to perceive their tax evasion as consistent with being a good, honest citizen.³⁵⁴

³⁴⁷ See *supra* text accompanying note 289; *supra* text accompanying notes 327-328.

³⁴⁸ See, e.g., Feld & Frey, *supra* note 297, at 1044 (“Positive (rewards) or negative incentives (deterrence) play a role, but it cannot be taken for granted that they induce tax compliance because they may also crowd out tax morale.”); Frey, *supra* note 346, at 92 (“The net effect of using punishment in an effort to establish legal behavior is counterproductive if the relative price effect of the punishment is smaller than the crowding-out effect.”); Frey & Feld, *supra* note 289, at 12 (“The feeling of being controlled in a negative way, and being suspected of tax cheating, tends to crowd out the intrinsic motivation to act as an honorable taxpayer and, as a consequence, tax morale will fall.”).

³⁴⁹ Frey, *supra* note 5, at 391.

³⁵⁰ Feld & Frey, *supra* note 297, at 107.

³⁵¹ See Lederman, *supra* note 3, at 699 (synthesizing studies and reaching this conclusion).

³⁵² See *supra* note 290 (citing sources).

³⁵³ Rosenberg, *supra* note 336, at 199 (footnote omitted) (emphasis added). He adds, “It is doubtful that anyone would ever consciously acknowledge that she thinks taxes are unfair because (rather than so) she cheats on her own taxes, but an individual’s lack of awareness of such a reverse-intuitive causal link does not mean that no such link exists.” *Id.* at 200.

³⁵⁴ *Id.* at 200-01.

Accordingly, Rosenberg argues that evading taxpayers use rationalizations to justify the behavior:

Whether this rationalization takes the form of “knowing” that the tax system is unfair, or “knowing” that the government is bad and misguided, is less important than the fact that, regardless of how individuals explain their tax evasion behavior to themselves and others, that explanation is likely to be some ex post rationalization rather than some guiding vision that motivates the behavior of tax evasion.³⁵⁵

If Rosenberg is right that claimed inequitable behavior by the government is simply a rationalization for the taxpayer’s intent to evade, at least for some people, better behavior by the government likely would not forestall such evasion. Without an easy scapegoat, evasion might be harder to justify, but some taxpayers might find an alternate rationalization for evasion, such as “everyone is doing it” or “they’ll never miss the money.” Better government behavior also likely would not affect committed evaders.³⁵⁶ From the standpoint of the fraud triangle, these may be the people who auditing standards describe as “possess[ing] an attitude, character, or set of ethical values that allow them knowingly and intentionally to commit a dishonest act.”³⁵⁷

The normative implication of this analysis is that it does not make sense to make good-government measures the sole or principal means of attempting to improve tax compliance. Certainly the government should treat people fairly as a matter of principle. Procedural justice may help tax compliance, as well.³⁵⁸ However, given taxpayers’ financial incentive to pocket tax dollars and the presence of opportunities to evade, the government should not only treat taxpayers fairly, it should also recognize the importance of enforcement and structural constraints on evasion.

Such an approach accords not just with intuition and the theoretical frame provided by the fraud triangle. Empirically, limiting the opportunity to evade and increasing the likelihood that evasion will be detected have very positive effects on tax compliance.³⁵⁹

³⁵⁵ *Id.* at 201.

³⁵⁶ Taxpayers may be conceptualized in three main categories: those who are always honest, those who will always try to cheat, and a vast majority whose behavior can be influenced. See Jon S. Davis, Gary Hecht & Jon D. Perkins, *Social Behaviors, Enforcement, and Tax Compliance Dynamics*, 78 ACCT. REV. 39, 40 (2003) (referring to “honest taxpayers, susceptible taxpayers, and evaders”); cf. Susan C. Morse, *Tax Compliance and Norm Formation under High-Penalty Regimes*, 44 CONN. L. REV. 675, 694 (2012) (referring to “determined evaders”).

³⁵⁷ AICPA, *supra* note 14, at § 240.A1; ISA 240, *supra* note 14, at A1.

³⁵⁸ See *supra* text accompanying note 342.

³⁵⁹ See *supra* text accompanying note 255 (reporting IRS voluntary compliance estimates, which increase as the IRS receives more information about the transaction); *supra* note 290 and accompanying text (citing research on the effectiveness of audits at decreasing tax evasion).

CONCLUSION

There is a significant literature on the fraud triangle, particularly in accounting journals. The AICPA also adopted a fraud triangle-based approach in SAS No. 99, “Consideration of Fraud in a Financial Statement Audit.” Some scholars have criticized the fraud triangle as having inappropriately extended beyond Donald Cressey’s initial focus on embezzlers and similar trust violators. It is true that the fraud triangle has evolved over the years, and that, perhaps due to its origin in Cressey’s offender-focused work, it does not focus much on societal causes of crime. However, Cressey’s factors were not simply adopted wholesale by the AICPA. Work by Steve Albrecht, the Treadway Commission, and others appears to have informed the development of the slightly different factors that studies have found typically apply in fraud cases.

Although the fraud triangle has been well studied, it has largely been overlooked by tax law professors and only rarely applied to tax evasion. Yet, it provides a useful lens when considering the tax evasion decision from an offender perspective. Most notably, the fraud triangle supports the idea that opportunity is a critical, but not the only, factor in tax evasion. The fraud triangle also supports the importance of the deterrence model while recognizing the importance of behavioral factors on the tax evasion decision.

Generally speaking, the triangle’s first two factors—incentive or pressure and opportunity—may be thought of as in line with the deterrence model, while the third factor—rationalization—accords with behavioral theories of compliance. While increasing compliance norms may help limit convenient rationalizations, structural systems constrain the opportunity to evade. In addition, enforcement should result in reductions of incentive and opportunity, while buttressing compliance norms. The fraud triangle thus provides a useful frame for showing how traditional economic and behavioral theories can co-exist and even work together. The usefulness of the fraud triangle to the understanding of tax evasion also underscores the value of accounting literature and criminology to the study of tax compliance and evasion.