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L. Murphy Smith, Editor
Murray State University

Katherine Taken Smith, Co-Editor
Murray State University

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ABSTRACT

Question: Can a couple called to serve on an 18-month religious mission away from their home deduct the unreimbursed food, lodging, incidentals, and transportation expenses associated with fulfilling that mission as charitable deductions if they expect to return to their prior home after their missionary service is completed? In the opinion of the authors, the answer to this question is "probably yes" when considering the missionary model used by the Church of Jesus Christ of Latter-day Saints, and the significance of Congressional intent as explained by the U.S. Supreme Court's Chevron case.

INTRODUCTION

The Supreme Court stated that a tax deduction ". . . is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer" (Interstate Transit Lines v. IRS, 1943). This famous tax statement, seemingly "held in awe" is quoted in over 1,000 court cases (Lowry, et al., p 389) and seems to create the statutory presumption of required legal proof and evidence against the taxpayer.

Numerous tax research articles seek to provide clarity when tax law creates a tax-interpretation ambiguity. Some differences of opinions have recently arose about allowed charitable contributions. These tax-deduction ambiguities, and the related efforts to provide clarity, can be found in some recent articles, such as, charitable deductions for taxpayers contributing to nonprofit organizations (Elson & Weld, 2011); how to structure charitable bequests for decedents (Hoyt, 2015); or disallowed charitable contributions given to a foreign church (No Charitable Deduction, 2010).

In the Church of Jesus Christ of Latter-day Saints, as well as many other churches and other charitable organizations, persons provide full-time service without compensation in furthering their organization's tax-exempt objectives. In that church, it is common for retired couples to be called to serve 18-month missions at locations far from their homes. The call comes from church headquarters in Salt Lake City, Utah and not from the local ward (the name used to describe their local church subdivisions within the greater church). The call usually comes in the form of a mailed packet of information with a specific call letter from the First Presidency of the Church of Jesus Christ of Latter-day Saints, as well as other informative materials. The letter informs the missionary couple of the location they are to serve, any language requirements, other preliminary preparation instructions, and the start date of their expected 18 months of service. At the end of the 18 month mission experience, the couple returns home.

Some missionaries are called to serve domestically and others in foreign countries. But the missionaries are called, directed, and controlled by the church headquarters in the United States which is an IRC Section 501(c)(3) organization. IRC Section 170(c)(2) defines "charitable contribution" as a contribution or gift "to or for the use of" an organization "created or organized in the United States . . . or under the law of the United States" (Anonymous v. CIR, 2010).

So this case, couple missionaries, is distinguishable from the case of *Anonymous v. C.I.R.* (2010), where the taxpayer was denied a charitable deduction for air fare to fly to a foreign country to serve a Catholic Church in that foreign country since she was not controlled by a church created or organized in the United States. Her local U.S. diocese knew she was going to that foreign country to serve the foreign church, but it did not direct or control her activities - they were all self-initiated by her.

The fact that the charitable work did not take place within the United States was not the important factor since the foregoing Tax Court case recognized the fact that the 5th Circuit Court of Appeals (Winn v. Commissioner, 1979) allowed a charitable deduction that ended up being used in a foreign country. The key factor in that case was the fact that the donation was made to a church organized in the United States and used by it to further its work in a foreign country.

The vast majority of missionary couples keep their homes and return to them when their missionary service is finished. When they leave on their missions, the church leaders in the their local wards release them from their local church responsibilities and fully expect them to return after their missionary service is finished to again take on local church responsibilities. Effectively, they are given a leave of absence regarding their local church responsibilities. While they are on their missions, their pictures typically hang in their local church foyers recognizing that (1) they belong to the local ward (2) their missionary call, from church headquarters, is only temporary and (3) they are expected to return to the local congregation, upon completion of their mission.

The vast majority of such missionaries retain their homes and either (1) leave them empty during their away-from-home missionary service, or (2) have a family member live in their home to take care of it during their temporary absence. In rare instances, they sell their homes before their missions with the expectation of buying replacement homes when they return from their missions. Only in very rare instances do they not actually return to their old community after their missions are ended.

In virtually all cases, at the time of any audit concerning such charitable deductions, the couple has returned home. Additionally, the couples have their call letter with specific and expressed information about their mission start and finish dates. In other words, whether or not the couple will return home is no longer an issue; returning home can be demonstrated by what actually happened at the end of their missions.

HISTORY OF THE TAX CODE REGARDING THE DEDUCTIBILITY OF AWAY-FROM-HOME TRAVEL EXPENSES AS CHARITABLE CONTRIBUTIONS

The charitable contributions deduction regarding travel expenses is ruled by IRC Section 170(j) which says in part:

> *No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.*

Missionaries do not serve missions for personal pleasure, recreation, or vacation purposes. Instead, they are sent to specific locations determined by church authorities to perform specific service duties as determined by church authorities. Typically, they perform their missionary services 6½ days per week. The missing half day is called "preparation day" to allow them to do their laundry, shop for groceries, write letters to family and the local wards from which they came, etc. Although they may find personal satisfaction in serving a mission, there is not church official time set or allowed for personal recreation or vacation.

Does the fact that a missionary derives personal pleasure or satisfaction from serving a mission prohibit the charitable deduction for traveling expenses? The Tax Court in *Cavalaris v. C.I.R.*, shed some light on the issue when it stated:

> Section 170(j) prohibits a deduction for, inter alia, unreimbursed traveling expenses incurred incident to the rendition of charitable services, "unless there is no significant element of personal pleasure, recreation, or vacation in such travel." The meaning of a "significant element of personal pleasure, recreation, or vacation" is far from self-evident. An inquiry into the legislative history of this provision provides some insight. The House report states:
>
> *In determining whether travel away from home involves a significant element of personal pleasure, recreation, or vacation, the fact that a taxpayer enjoys providing services to the charitable organization will not lead to denial of the deduction. For example, a troop leader for a tax-exempt youth group who takes children belonging to the group on a camping trip may qualify for a charitable deduction with respect to his or her own travel expenses if he or she is on duty in a genuine and substantial sense throughout the trip, even if he or she enjoys the trip or enjoys supervising children. By contrast, a taxpayer who only has nominal duties relating to the performance of services for the charity, or who for significant portions of the trip is not required to render services, is not allowed any deduction for travel costs [H. Rept. 99–426, 129 (1985)].*

The example makes clear that the relevant inquiry is the extent and duration of the charitable services provided by the taxpayer, and not some quantum measure of pleasure derived by the taxpayer (Cavalaris v. CIR, 1996).

Interpreting IRC Section 170, Treasury Regulation 1.170A-1(g) says in part:

> *No deduction is allowable under section 170 for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization [,] contributions to which are deductible [,] may constitute a deductible contribution. For example… out-of-pocket transportation expenses necessarily incurred in performing donated services are deductible. Reasonable expenditures for meals and lodging necessarily incurred while away from home in the course of performing donated services also are deductible. For the purposes of this paragraph, the phrase "while away from home" has the same meaning as that phrase is used for purposes of section 162 and the regulations thereunder.*

As will be discussed later, it is argued in this article that the last sentence in this Treasury Regulation quotation has effectively been partial repealed by what the Conference Committee said concerning the changes it made to IRC Section 162(a) in the *Energy Policy Act of 1992* (1992). It is argued that because of what Congress did there, the tests for away-from-home expenses have diverged in the contexts of IRC Sections 162 and 170 - at least regarding duration considerations.

Revenue Rulings, Interpretive Suggestions of a Tax "Fork in the Road"

In Revenue Ruling 83-82 (1983), the IRS said that under IRC Section 162 regarding trade or business expenses, in order for a taxpayer to deduct transportation, meals, and lodging expenses "while away from home" the absence from home must be "temporary" as opposed to "indefinite." Then it provided guidance on three possible time periods — (1) an absence of less than one year; (2) an absence of at least one year, but less than two years; and (3) an absence of two years or longer.

Pursuant to that Revenue Ruling, a taxpayer is most likely to be treated as temporarily away from home if the absence is less than one year. If a taxpayer is away from home for more than two years, the taxpayer is not temporarily away from home.

The middle category is the one that most interests us here since an 18-month mission falls between one and two. Revenue Ruling 83-82 created a rebuttable presumption that such a long absence would not be considered "temporary" for purposes of qualifying to deduct away-from-home expenses. Thus, incurring away-from-home expenses over such a long period of time is not deductible unless the taxpayer successfully rebuts or refutes that presumption. Revenue Ruling 83-82 provides the following guidance with regard to the rebuttable presumption.

To rebut the 1-year presumption of indefiniteness with respect to employment that lasts for 1 year or more but less than 2 years, the taxpayer must clearly demonstrate by objective factors that the taxpayer realistically expected that the employment in issue would last less than 2 years and that the taxpayer would return to the claimed tax home after the job terminates. In addition, the taxpayer must show that the claimed tax home is the taxpayer's regular place of abode in a real and substantial sense. There are three objective factors that may be used to determine, with respect to the taxable year in question, the bona fide nature of the taxpayer's assertion that the claimed abode is the taxpayer's regular place of abode in a real and substantial sense. They are:

1. Whether the taxpayer has used the claimed abode (for purposes of the taxpayer's lodging) while performing work in the vicinity thereof immediately prior to the current job and the taxpayer continue [sic] to maintain bona fide work contacts (job seeking, leave of absence, on-going business, etc.) in that area during the alleged temporary employment;
2. Whether the taxpayer's living expenses at the claimed abode are duplicated because work requires the taxpayer to be away from the abode; and,
3. Whether the taxpayer (a) has a family member or members (marital or lineal only) currently residing at the claimed abode, or (b) continues to currently use the claimed abode frequently for purposes of the taxpayer's lodging.

First, it should be noted that it said: "There are three objective factors that may be used to determine…the bona fide nature of the taxpayer's assertion that the claimed abode is the taxpayer's regular place of abode in a real and substantial sense" (emphasis added). It didn't say "will" or "must" — just "may." This means that the stated criteria is not mandatory and infers that other criteria could be considered and not just those three factors.

Second, even though Treasury Regulation 1.170A-1(g) says that the determination of allowable charitable deductions related to transportation, meals, and lodging expenses "while away from home" effectively piggy-backs off of the rules regarding the deductibility of such away-from-home expenses in the "trade or business" context of IRC Section 162, it is obvious that the verbiage used to discuss the rules in the trade or business context do not easily carry over to the charitable deduction area. This suggests a needful fork in the road regarding the potential objective criteria that should be considered in refuting the negative presumption in the charitable deduction context.

For example, the terms "bona fide work contacts (job seeking, leave of absence, on-going business, etc.)" used by the IRS in discussing the first factor that may be considered under the above Revenue Ruling, make no sense in the charitable deduction context where the taxpayer is not working in a regular remunerative job, but rather, is retired and incurs away-from-home expenses in serving a church mission.

Thus, of necessity, in determining whether or not away-from-home expenses are deductible in the charitable context, we must resort to analogical extensions between the two contexts — in other words, we must take more of a "spirit of the law" approach than a "letter of the law (or IRS rule)" approach. We will illustrate this a little later. So far, our historical discussion only applies to pre-1993 expenses since things were changed somewhat by the *Energy Policy Act of 1992* (1992).

Energy Policy Act of 1992, the One-Year Rule for Trade or Business

Effectively under this law, in the context of deducting away-from-home expenses incurred in a "trade or business" under IRC Section 162(a)(2), prior to the change caused by *Energy Policy Act of 1992* (1992), it read:

> *There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including —... (2) travelling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business…."*

Congress reduced to two, what had been three relevant time periods to consider. First, let's review IRC Section 162 Section 1938 of that Act modified IRC Section 162(a) to read:

> *For purposes of paragraph (2) [dealing with away-from-home travel expenses], the taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year (Energy Policy Act of 1992, (1992).*

After discussing the then current practice of considering three possible away-from-home time periods (i.e. (1) less than one year, (2) one year or more but less than two years, and (3) two years or more), the Conference Committee report for the *Energy Policy Act of 1992* (1992) said:

> *The conference agreement treats a taxpayer's employment away from home in a single location as indefinite rather than temporary if it lasts for one year or more. Thus, no deduction would be permitted for travel expenses paid or incurred in connection with such employment. As under present law, if a taxpayer's employment away from home in a single location lasts for less than one year, whether such employment is temporary or indefinite would be determined on the basis of the facts and circumstances (COMREP, 1992).*

So, Congress decided to make a "bright line" test regarding the deductibility of away-from-home expenses in the "trade or business" context of IRC Section 162 and said that being away from home for one year or more is not considered "temporary." Thus, away-from-home expenses incurred in that context are no longer deductible under IRC Section 162.

CONGRESSIONAL INTENT EXPRESSLY STATED, CREATES ANOTHER TAX "FORK IN THE ROAD"

Now here is where things get interesting concerning our lead-in question regarding 18-month religious missions. While at first one might easily conclude that same "one year or longer" bright line test now applies to charitable deductions for away-from-home expenses associated with missionary service, that would be incorrect. This is because after the Conference Committee said what it did in its committee report quoted above, it followed up by stating:

> *This change is not intended to alter present law with respect to volunteer individuals providing voluntary services to charities described in section 501(c)(3) (emphasis added) (COMREP, 1992).*

This is a very clear statement of Congressional intent regarding their statutory change of the law. In the case of *C.I.R v. Bilder* (1962), the U.S. Supreme used committee reports to decipher Congressional intents, which in that case, supported the IRS position. It even refused to address an alternative argument made by the IRS since the committee report was so clear regarding Congressional intent.

Since prior to those statements, the Conference Committee summarized the then current 3-period test used for determining the deductibility of away-from-home expenses in both the "trade or business" context of Section 162 and the charitable contribution deduction in the context of Section 170, it is obvious that Congress only intended to change the existing rules in the "trade or business" context and *not* in the charitable contribution context.

When a Bill passes in one of the Houses of Congress, it must also be passed by the other House before it is sent to the President for his signature to actually become statutory law. As is usually the case, when a Bill passes one House and is sent to the other, the other House makes changes to it before passing its version of the Bill. At that point a Conference Committee is convened to resolve the differences between the two respective Bills through debate and compromise. It is made up of selected Senators and Congressmen from both Houses. Once the Conference Committee arrives at a mutually acceptable compromise between the two versions of the Bill, their compromise Bill is sent to both Houses for passage. If it passes in both Houses, it is sent to the President to either sign into statutory law, or veto.

Because of that process, Conference Committee Reports discussing what they did in conference and why they did it, are clear expressions of Congressional intent of both Houses regarding the Bills that pass their committee.

The Chevron Case — Judicial Deference to Agency Actions

In *Chevron v. Natural Resources Defense Council Inc. (1984)*, the U.S. Supreme Court determined how much judicial deference would be given to federal agency regulations that attempt to fill in the gaps which exist in the statutory law created by Congress. The Supreme Court said:

> *When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions.* ***First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter;*** *for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress…." (emphasis added)*

Since that first *Chevron* (1984) question was answered in the affirmative in the above quoted Conference Committee Report regarding the *Energy Policy Act of 1992* (1992), there is no need to discuss the second *Chevron* (1984) question dealing with the case where Congress was silent about its intent.

With regard to the temporarily-away-from-home rule, Congress explicitly said that it only intended to change the then existing rules regarding away-from-home expenses in the context of "trade or business" deductions under IRC Section 162 and not away-from-home expenses in the context of charitable deductions under IRC Section 170.

This means that the old rule still applies to temporarily away from home expenses relating to charitable contributions, namely, that there are still three relevant time periods to consider in determining the deductibility of away-from-home expenses incurred while serving charitable organizations and that such expenses are still potentially deductible regarding 18-month religious missions.

SO, CAN A TAXPAYER SERVING AN 18-MONTH MISSION FOR HIS OR HER CHURCH QUALIFY TO DEDUCT UNREIMBURSED AWAY-FROM-HOME EXPENSES WHILE ON THAT MISSION?

After the passage of the *Energy Policy Act of 1992* (1992), the Internal Revenue Service issued Revenue Ruling 93-86 (1993) that "obsoleted" Revenue Ruling 83-82 since that Revenue Ruling only explicitly dealt with "trade or business" deductions for away-from-home travel expenses and all of the examples used there were in the 1-2 year range which, because of the changes made by that Act to IRC Section 162, could no longer qualify as deductible away-from-home travel expenses.

However, since away-from-home travel expenses associated with charitable services can still be deducted within the 1-2 year range, the criteria expressed in Revenue Ruling 83-82 should be evaluated since it is likely the IRS will consider those same standards in deciding whether or not to allow charitable contribution deductions for away-from-home expenses associated with 18-month religious missions.

Ultimately, the answer to the foregoing question depends upon the facts and circumstances. As mentioned above, the absence must be "temporary" rather than "indefinite." The main issue is whether the taxpayer really (1) has an established home and (2) intends to return to it after his service terminates. Regarding trade or business expenses under IRC Section 162, the IRS said it wanted to see objective evidence to support that claimed intention. In this regard, Revenue Ruling 83-82 stated:

> *…the taxpayer must clearly demonstrate by objective factors that the taxpayer realistically expected that the employment in issue would last less than 2 years and that the taxpayer would return to the claimed tax home after the job terminates. In addition, the taxpayer must show that the claimed tax home is the taxpayer's regular place of abode in a real and substantial sense.*

Regarding the "real and substantial" nature of his home, the above Revenue Ruling referred to a prior Revenue Ruling 73-529 (1973) that used the word "itinerant" four times. It talked about an itinerant as being one who does not have an established home but whose home is wherever he happens to be at the time. In Revenue Ruling 93-86 (1993), the word "itinerant" was used in the same meaning as Revenue Ruling 73-529 (1973).

Revenue Ruling 73-529 (1973) set forth three objective criteria very similar to the ones discussed in Revenue Ruling 83-82 (1983) that demonstrate the taxpayer intended to return to his prior home. Revenue Ruling 73-529 (1973) observed: "Although such an inquiry basically is subjective, there are three objective factors that may be used to determine [the issue — at least from the IRS' point of view]…" The three objective factors are very similar to those discussed in Revenue Ruling 83-82 (1983). Revenue Ruling 73-529 (1973) also noted:

> *Neither the Service nor the courts have attempted to prescribe any specific criteria delineating the dividing line between the itinerant taxpayer who has his 'home' wherever he is working, and the taxpayer who because of the nature of his business, has no regular or principal place of business but does have a 'regular place of abode in a real and substantial sense.' The [Internal Revenue] Service will recognize that a taxpayer has a 'home' for traveling expense deduction purposes if he claims an abode and, under bona fide circumstances, satisfies all three objective factors set forth in the preceding paragraph. If a taxpayer…does…satisfy two of the three objective factors set forth in the preceding paragraph, then all the facts and circumstances of his case will be subjected to close scrutiny to determine whether he has a 'home" for traveling expense deduction purposes….*

It is interesting to note that the examples used in Revenue Ruling 83-82 (1983) covered situations where, all, one, or none of the three objective factors were met, but not the situation where the taxpayer met two out of the three factors as was discussed in Revenue Ruling 73-529 (1973).

By virtue of the fact that Rev. Rul. 83-82 (1983) said that it meant to only "clarify" Revenue Ruling 73-529 (1973) (as opposed to "supersede" it, "retract" it, etc.), it implied that the positions taken by the IRS in Revenue Ruling 73-529 (1973) would still have currency to the extent they were not contradicted in Revenue Ruling 83-82 (1983). In other words, if a taxpayer met only two of the three objective factors, it is possible for the taxpayer to deduct his away-from-home travel expense if a close scrutiny of the facts and circumstances warranted such an outcome. That implied that the IRS would be willing to consider more than just those three objective factors set forth in both those Revenue Rulings in determining whether or not the taxpayer could effectively rebut the rebuttable presumption against deductibility when the temporary absence from home was one year or more, but less than two years in duration.

In Revenue Ruling 73-529 (1973) the IRS used an example where none of the three objective factors it discussed were met. It concluded in that example that it would not allow the taxpayer to deduct his traveling expenses since in its view; he was not "away from home." It is interesting to note that the IRS also mentioned the Tax Court's *Gustafson* (1944) case that dealt with very similar facts to that example (which met none of the IRS' "three objective factors"). In that case the Tax Court disagreed with the IRS and ruled that the taxpayer was considered to be "away from home" at the time he incurred his traveling expenses.

In that Revenue Ruling 73-529 (1973), the IRS indicated that while it originally acquiesced to the Tax Court holding, it withdrew its acquiescence in 1973. Going forward, the IRS would be willing to fight taxpayers who were away from home for at least one year but not over two years and who tried to deduct traveling expenses when they couldn't meet any of its "three objective factors." Such action would force taxpayers to petition the Tax Court, District Court, or other recognized trial court to resolve their disputes with the IRS.

Revenue Rulings versus Congressional Intent

Normally, a Revenue Ruling is issued when a taxpayer's prospective tax situation would carry significant tax implications and the IRS desires to express its position for general application to all taxpayers as opposed to the positions it expresses in Private Letter Rulings which are only intended to have effect on the specific taxpayer who requested the ruling (Sawyers, Raabe, Whittenburg, & Gill, 2015).

When the IRS issues a favorable Revenue Ruling on transaction taxpayers can proceed with their intended transactions knowing in advance what the tax consequences will be and knowing that the IRS will not dispute the tax positions taken by those taxpayers if later audited.

When the IRS issues an unfavorable Revenue Ruling on a transaction, taxpayers are faced with a more difficult decision as to whether or not to enter the transaction. The taxpayer can expect the IRS to dispute the desired tax consequences it audits. But as the *Gustafson* (1944) case illustrates, the courts are not required to accept the IRS' position on any tax matter—the ultimate tax consequences will be determined by the courts as per the verbiage of the tax code, expressions of Congressional intents, prior case precedents interpreting and applying the various tax laws, their own reasoning and analysis, etc.

Revenue Rulings represent insights as to what to expect from the IRS regarding tax consequences of various transactions. If a taxpayer can structure a transaction that fits within the criteria set forth in a Revenue Ruling, then the ruling serves as a "safe harbor" for the taxpayer. This is consistent with the language in the first sentence of Revenue Ruling 83-82 where it states that the content of the ruling are "guidelines" for taxpayers.

So to summarize the import of both Revenue Ruling 73-529 (1973) and Revenue Ruling 83-82 (1983), the IRS set forth three objective factors that it would consider in determining whether or not it would allow a taxpayer to deduct away-from-home travel expenses. If the taxpayer met all three, the IRS would allow the deductions. If the taxpayer met two of the three, the IRS would subject the taxpayer's facts and circumstances "to close scrutiny to determine whether he had a 'home' for traveling expense deduction purposes." If the taxpayer met, only one or none of those three factors, the IRS would deny the taxpayer's deductions and force him into court to resolve the issue. The fact that the IRS proposed three factors to consider does not mean that the courts would limit their inquiry to just those three factors in ultimately determining the matter.

As mentioned above, since there are significant differences between remunerative employment and charitable services, the verbiage used by the IRS in those Revenue Rulings does not easily carry over to a discussion of one's being "away from home" in determining the deductibility of travel expenses as charitable deductions. The most reasonable implication of this is that other factors will probably also be considered by both the IRS and the courts in determining the issue in that context.

OTHER FACTORS TO CONSIDER

Revenue Ruling 93-86 (1993) was consistent with the other two Revenue Rulings cited regarding the two basic issues involved, namely, (1) Did the taxpayer establish a home in a "real and substantial sense?"; and (2) Was the absence away from home definite and temporary as opposed to indefinite?

It didn't mention the three objective factors discussed in the prior Revenue Rulings since before 1993, they could be used to rebut the presumption against deductibility regarding away-from-home absences that were expected to last somewhere between one and two years. The *Energy Policy Act of 1992* (1992) had effectively changed that rebuttable presumption of non-deductibility into an absolute certainty, so there was no need to discuss them any more in the "trade or business" context. In Revenue Ruling 93-86, it appears that absences from home that are expected to last less than one year, are rebuttably presumed to be deductible as a "trade or business" expense under IRC Section 162.

We found no Revenue Rulings specifically dealing with the deductibility of away-from-home travel expenses to charitable donations after 1992. Moreover, we could find no post-1992 court cases dealing with the deductibility of away-from-home traveling expenses as charitable deductions when the taxpayers were away from home for more than one year but less than 2 years. Therefore, we must rely upon the law as it existed prior to the *Energy Policy Act of 1992* (1992).

In our analysis, we will assume both the IRS and the federal courts will comply with the clear Congressional intent expressed in the Conference Committee Report to the *Energy Policy Act of 1992* (1992) since, as the U.S. Supreme Court said in its *Chevron* (1984) case, ". . . If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."

Being Temporarily "Away From Home" in a Charitable Mission Context Seems to be a Clearer Case to Determine than the "Trade or Business" Context.

As discussed above, the critical issues to be resolved are whether or not (1) that taxpayer has established a home in a "real and substantial sense," and (2) whether the taxpayer's absence from that home is only "temporary" rather than "indefinite."

Consider the most common facts and circumstances surrounding an 18-month mission for older couples. The missionaries are typically retired and have lived in their home for several years before being called on an 18-month mission so there is no question they are leaving what has been their home in a "real and substantial sense."

They agree to serve wherever the church decides to send them and perform whatever charitable services the church needs them to perform. There is no "vacation" aspect to their mission. They either leave their houses empty or leave their homes in the hands of a caretaker while serving a mission. The fact that they are retired and do not sell their home or move their furnishings out before leaving on their mission strongly indicates that they intend to return to their prior home once their mission ends.

Moreover, the couple has received a letter from church headquarters indicating definite departure and return dates. Such a letter is clear evidence of the temporary nature of the mission.

They and everyone else in their ward expect they will return at the end of their mission. While temporarily gone, the couple's picture hangs in the foyer of the local church building so that everyone will remember where they are and be able to estimate when they will see the couple rejoin their congregation in the future based upon the date they left which is indicated with their picture. If one were to randomly survey a member of any ward in that church, they would almost certainly say that the foregoing typifies what they have actually seen happen time, and time again in their ward.

In the trade or business context under IRC Section 162, it is common for people to always be looking for a better job which diminishes the chances of the worker actually returning to his prior home. In contrast, a retired couple is much more likely to have chosen where they want to live out their retirement years and are far more likely to actually return home after their missions.

Considering the three objective factors set forth by the IRS in Revenue Ruling 83-82 and Revenue Ruling 73-529 in the "trade or business" context, the first factor does not fit well regarding a retired couple in the charitable context who are no longer looking for work. They are simply not going to "continue to maintain bonafide work contacts (job seeking, leave of absence, on-going business, etc.)" in their home area while they are away. But the way they are treated when they leave on their mission from their home ward, is analogous to a temporary "leave of absence."

The second factor is the easiest of the three to transport from the "trade or business" context over to the charitable context. Since the missionary couple maintains the costs associated with their prior home and incur costs associated with living away from home, their costs are duplicated so the second factor is met.

The third factor also does not easily carry over from the "trade or business" context to the charitable context. While it may be common for a working person to occasionally return home over the course of his temporary absence while working away from home that is virtually unheard of in the mission context. The very strong expectation of the church, the missionaries, and the ward members is that once someone goes out on a mission, he or she will not return home even once before the mission comes to an end, which ending occurs like clockwork based upon the stated duration of the mission, in their call letter, and when it began.

Regarding another aspect of that third factor, while leaving a family member in the home during the taxpayer's temporary absence would strongly suggest the taxpayer intended to return, just leaving the missionary couple's furniture behind in their home in and of itself, strongly suggests they really do intend to return there after their mission whether or not anybody stayed in their home during their absence. In the "trade or business" context, it is likely the taxpayer is a younger person with children still living at home. Regarding retired couples who go on missions, their children have probably left the home long ago — there is nobody to leave behind. So again, this "objective factor" does not carry over well to the charitable contribution context.

We are confident that the courts would consider things above and beyond what the IRS did in Revenue Ruling 73-529 (1973) and Revenue Ruling 83-852 (1983). We are also confident that in most cases, the courts would probably have an easy time determining that (1) the missionary couple had established a home in a "real and substantial sense," and (2) based upon the very strong and almost universal cultural expectations of the church and its members, the absence was definitely "temporary" as opposed to indefinite.

Moreover, if the missionaries were audited by the IRS and denied the charitable deductions of their missionary travel expenses, by the time that happened, they would have returned home. A court could see that not only was it very likely they would return when objectively considering things at the start of their mission, but they actually did return — allowing the court to determine the matter based upon actual occurrences instead of just stated intentions.

If the Missionaries Deducted Their Travel Expenses While Away From Home, Would They Have to File a Form 8275 Informing the IRS They are Taking an Aggressive Tax Position?

The Form 8275 Disclosure Statement is an IRS form used by the taxpayer to disclose tax positions that are not adequately disclosed on the tax return. The form is filed to avoid accuracy - related penalties due to disregard of rules or to a substantial understatement of income tax. In our opinion, a taxpayer taking charitable contribution deductions relating to travel expenses while temporarily away from home on a church mission, is not required to file Form 8275, Disclosure Statement. If the retired couple sold their home before leaving on their mission (thus increasing the chances that they might not return to their prior community once their mission ends) or rented out their home while they were gone (thus arguably not sustaining duplicative costs), the outcome would not be as certain. Our recommendation is that they complete the appropriate charitable contribution schedule and forms and attach such claimed reasonable travel tax deductions to Schedule A, of Form 1040.

Reasonable Travel Expenditures

Reasonable travel expenditures have caused some dispute between the taxpayer and the IRS. In the case of *Cavalaris v. C.I.R.* (1996), the Tax Court stated:

> Respondent [the IRS] asserts that some expenses were lavish or extravagant and that some expenses were not required to be paid by petitioner. Both assertions raise the question whether the expenses were reasonable and/or necessary. Section 1.170A–1(g), Income Tax Regs., provides, in relevant part:
>
> *Similarly, out-of-pocket transportation expenses necessarily incurred in performing donated services are deductible. Reasonable expenditures for meals and lodging necessarily incurred while away from home in the course of performing donated services also are deductible.*
>
> A requirement of reasonableness is inherent in the concept of necessary. *Boser v. Commissioner*, 77 T.C. 1124, 1133 (1981). Thus, expenses for travel, meals, and lodging must be both reasonable and necessary. With these guidelines in mind we turn to petitioner's expenditures for meals, lodging, transportation, and other travel expenses.
>
> Petitioner typically stayed at “deluxe” hotels during his travels. For instance, on a trip to Baltimore, Maryland (paragraph 9 of the stipulation of facts), petitioner stayed at the Peabody Court at a rate of $180 per night. Similarly, on an 11–day AHEPA trip to Fort Lauderdale and Miami Beach, Florida (paragraph 10 of the stipulation of facts), petitioner stayed at the Sheraton Bonaventure Resort and Spa and the Doral Ocean Beach Resort, respectively, incurring lodging charges of $1,602.69. Respondent does not dispute the need for lodging on these or similar trips, but rather the reasonableness of the expenditures. While few would characterize petitioner's choices of accommodations as frugal, they were generally convenient. Petitioner often stayed at the hotel hosting the meeting he was attending. When petitioner could not obtain a room at the hotel hosting the meeting he would stay at a similarly priced hotel in the vicinity. This practice saved petitioner additional travel costs. In addition, petitioner held relatively prestigious positions in large charitable organizations, such that staying in quality lodgings may have been acceptable practice. Bearing in mind that reasonableness is a relative term, we conclude that petitioner's expenditures for lodging were reasonable.

Documenting Reasonable Charitable Travel Expenditures

Regardless that the courts have determined charitable travel expenditures substantiation-reporting requirements are not as stringent as those required for trade or business (Cavalaris b.

C.I.R., 1996), missionaries nonetheless should be diligent in keeping track of their reasonable travel expenditures.

The missionaries should keep a copy of their formal missionary call and need to be very meticulous in keeping their receipts and other records of the various payments indicating what each was for—credit card bills will probably not be sufficient (Van Der Lee v. C.I.R. (2012). Except for common receipt-less expenditures like laundry expenses and other common incidental costs, estimating payments may not be sufficient, so it would be important to maintain a contemporaneous log with specific dates and amounts of all expenses claimed as charitable deductions. We suggest the following format:

- Expenditure date:
- Amount:
- Paid to:
- Purpose:
- Date this entry was made:

We also suggest that all receipts and bank statements showing disbursements that corroborate the forgoing expenditures be kept in chronological order to substantiate the amounts appearing in the contemporaneous log. This recommendation is predicated upon Treasury Regulation 1.170A-13(a), which reads, in part as,

1. The taxpayer shall maintain for each contribution one of the following:

> (i) A cancelled check.
> (ii) A receipt from the donee charitable organization showing the name of the donee, the date of the contribution, and the amount of the contribution. A letter or other communication from the donee charitable organization acknowledging receipt of a contribution and showing the date and amount of the contribution constitutes a receipt for purposes of this paragraph (a).
> (iii) In the absence of a canceled check or receipt from the donee charitable organization, other reliable written records showing the name of the donee, the date of the contribution, and the amount of the contribution.

2. Special rules — (i) Reliability of records. The reliability of the written records described in paragraph (a)(1)(iii) of this section is to be determined on the basis of all of the facts and circumstances of a particular case. In all events, however, the burden shall be on the taxpayer to establish reliability. Factors indicating that the written records are reliable include, but are not limited to:

> (A) The contemporaneous nature of the writing evidencing the contribution.
> (B) The regularity of the taxpayer's recordkeeping procedures. For example, a contemporaneous diary entry stating the amount and date of the donation and the name of the donee charitable organization made by a taxpayer who regularly makes such diary entries would generally be considered reliable.

We recommend that each evening the log be updated for the expenditures that took place that day and the receipts clipped together with prior receipts and kept in chronological order in some sort of envelope or file.

If a particular receipt is not clear as to date, amount, or the issuer, it would be useful for them to develop the habit of carefully and immediately examining what is on the receipt when they get it, and clearly indicating the missing information on the back of the receipt at that same moment. Then if the IRS later questions any of those receipts, the couple could describe their habit and assure the auditor that all the information added on the back of a particular receipt was put there contemporaneously with their physical receipt of it and while everything was fresh in their minds. We further recommend that the couple keep a missionary journal with entries each day as to what work was performed, the names of contacts made, etc. to clearly demonstrate that they were there to work rather than to take a vacation.

We think it wise to complete the daily logs and journals in handwriting since the physical appearance of the logs and journals (e.g. age from fading ink over time, different pens being used, crumpled pages, alternating handwriting of each spouse when they take turns keeping their expense logs, etc.) would suggest it was created contemporaneously with the payments of the expenditures rather than all at once after the fact to support a claim for the charitable deductions taken. This may sound ridiculous but the courts tend to be skeptical of taxpayer claims regarding away-from-home travel expenses and require clear and credible contemporaneous substantiation to have any chance for deductibility.

We should also note that entertainment expenses and sightseeing expenses will probably not qualify for deductions that are unrelated to the charitable work or deemed extravagant.

Optimally, the missionaries should establish these habits at the start of their missions and consistently observe them throughout their missions. Regarding missionaries who are currently serving but have not established such complete record-keeping habits to date, they can start now and at least have a good chance of deducting their unreimbursed away-from-home travel expenses prospectively.

CONCLUSION

Although the facts and circumstances might, on rare occasions, be significantly different from the typical ones assumed above, in our opinion, the typical retired couple who serve as companion missionaries on 6-, 12- or 18-month missions, should be able to deduct as charitable deductions pursuant to IRC Section 170, their reasonable travel, lodging, incidentals, and food expenses while away from home on their mission.

They will have to demonstrate facts sufficient to rebut the IRS presumption that they cannot take those deductions, however, in our opinion that can successfully be done, based on the facts in the typical missionary setting described above.

We have used the typical facts associated with a mission for the Church of Jesus Christ of Latter-day Saints because those facts are so familiar to us. To the extent the principles discussed here apply to missions in other churches or charitable services performed on behalf of non-religious domestic charitable organizations, their unreimbursed temporary away-from-home travel expenses should likewise be deductible when the fixed lengths of their charitable service assignments do not extend for two years or longer.

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NEW TACTICS IN FIGHTING FINANCIAL CRIMES: MOVING BEYOND THE FRAUD TRIANGLE

Richard McMahon, University of Houston-Downtown
Diana Pence, University of Houston-Downtown
Linda Bressler, University of Houston-Downtown
Martin S. Bressler, Southeastern Oklahoma State University

ABSTRACT

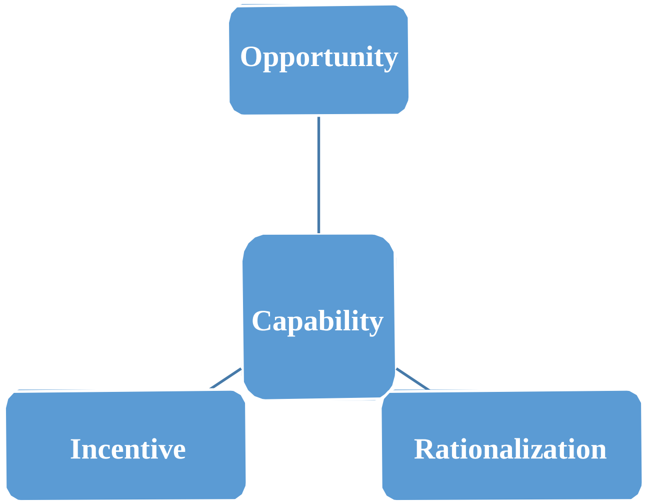
Financial crimes are not new--they have been around for centuries. However, only in more recent times have we begun to explore and attempt to understand why they occur. We attempt to do this not simply for psychological understanding, but also to develop defensive strategies to prevent future financial crimes. In this paper, the authors discuss conditions typically present that allow persons within and outside the firm the opportunity to commit crimes. The authors then offer additional preventive measures and conclude with recommendations for management.

INTRODUCTION

Fraud and financial crimes can be noted throughout history and financial statement fraud can be documented as early as the 1600's (Dorminey, Fleming, et al.). Sarna (2010) relates the story of the Tulip Bulb scandal of 1636 (often considered the first well-documented instance of securities manipulation fraud) and how it significantly affected the Dutch exchange market. In the 1920's, Carlo Ponzi (who the Ponzi Scheme is named after) duped thousands of investors out of more than $20 million dollars, causing six banks to fail (Burnsed, n.d.).

Cressey's (1973) Fraud Triangle examined the motivation for crime which included pressure (or incentive), opportunity, and rationalization as factors that can be helpful when trying to identify fraudulent activity. However, Dorminey, et al. (2012) believed that the Fraud Triangle was only one important piece of identifying the risk of assurance services. The authors note a challenge for the fraud triangle can be that not every fraud occurrence may be identified by the fraud triangle theory. The authors state that fraudsters' motivation may be expanded and identified with the acronym MICE: money, ideology, coercion, and ego or entitlement. In addition, Wolfe and Hermanson (2004) identified an important fourth element which they thought should be added to Cressey's (1973) Fraud Triangle. The authors believed that capability was equally as important as Cressey's initial three factors. Adding the element of capability to the Fraud Triangle as shown in Figure 1, could aid in fraud prevention and detection.

Figure 1
THE NEW FRAUD TRIANGLE (ADAPTED FROM CRESSEY, 1973)



Wolfe and Hermanson (2004) noted that many of the multimillion-dollar frauds could not have been perpetrated had it not been for the fraudsters' capabilities in place at the time of the fraud opportunity. For example, a CFO or Division Manager would have signing authority that other lower-level staff may not possess. In addition, the authors also mentioned that the person with the opportunity would need to be savvy enough to understand control weaknesses as well as have the capability to over-rule or ignore valuable internal controls. Capability would be especially important with frauds being perpetrated in collusion with others as well.

When thinking about fraud prevention managers would do well to remember Benjamin Franklin's (1735) axiom that "An ounce of prevention is worth a pound of cure." Therefore, in the next two sections we will first discuss fraud's prevention and then its detection. After that, the following sections will include fraud's investigation with its likely resultant data loss and the need for preserving a company's remaining data.

TERMS

Computer Forensic Analysis

The collection of techniques and tools used to find evidence in a computer (Ramaswamy, 2005).

Corporate Governance

Corporate governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. "The system of checks and balances designed to ensure that corporate managers are just as vigilant on behalf of long-term shareholder value as they would be if it was their own money at risk". (http://www.allbusiness.com/glossaries/corporate-governance/4950000-1.html).

Financial Accounting Standards Board (FASB)

Nongovernmental body with the authority to promulgate Generally Accepted Accounting Principles (GAAP) and reporting practices and are published in the form of FASB Statements. (http://www.allbusiness.com/glossaries/financial-accounting-standards-board-fasb/49508591.html).

Financial Fraud

Financial statement fraud is deliberate misrepresentation, misstatement or omission of financial statement data for the purpose of misleading the reader and creating a false impression of an organization's financial strength (Agarwal & Medury, 2014; http://smallbusinesss.chron.com.)

Sarbanes-Oxley Act

Federal law enacted in 2002 that introduced major reforms in corporate governance and financial reporting (also called the Corporate Responsibility Act) is regarded as the most sweeping securities legislation since the securities and exchange act of 1934. (http://www.allbusiness.com/glossaries/sarbanes-oxley-act/4947051-1.html).

DISCUSSION

Fraud Prevention

The top priority for a firm’s management team should be preventing fraud from occurring rather than reacting to it after fraud has been detected (Giles, 2012). Once a fraud incident is detected, the stressful, time-consuming job of recovering is often a difficult task and it can impact profits, damage reputations, and lower overall morale throughout the company affecting managers, workers, investors, associates, and even the surrounding communities.

Fraud is difficult to detect because it is hidden and deceptive but fraud prevention or deterrence can be increased by perception when what is perceived becomes as powerful as reality (Giles, 2012). That is, someone who perceives that they will probably be caught (detected) when they commit fraud is less likely (deterred) to commit the fraudulent act in the first place. The level of deterrence (deterrence factor) can be increased by using a combination of deterrent measures such as surprise audits, asking about fraud during audits, whistle-blowing hotlines, surveillance and monitoring, enforcement of policies, data mining exercises, as well as prosecuting fraudsters and publicizing successful convictions (Sharma & Panigrahi, 2012).

Preventing fraud can occur at many different levels – from basic security measures, both physical and digital, to developing a company-wide fraud prevention attitude. For instance, although it may seem simple, locked doors, security patrols, and strong passwords on employee computers can be excellent access control measures that stop fraud before it happens. Cazier and Medlin (2006) researched E-commerce passwords and how quickly passwords could be “cracked” p. 45. In their study, they examined individual passwords created by customers on e-commerce websites in relation to the strength of the password. The authors concluded that it could indeed be more difficult for perpetrators to hack into a customer’s account when customers chose stronger passwords.

In addition, Cazier and Medlin (2006) recommend the policy (however inconvenient for customers) to require certain characteristics of password digits such as upper case, numbers, special characters, etc. Furthermore, the authors also suggested requiring password changes several times per year because most consumers do not realize that not only will their personal accounts be at risk, but all information on the system can be at risk from fraudulent activity once a perpetrator penetrates the system via a weak password or some other manner.

The implementation of fraud controls will also help prevent fraud from occurring. These controls can be characterized as hard prevention or soft prevention controls (Giles, 2012). Hard prevention controls (i.e., staff vetting, job rotation and mandatory vacations, and anti-fraud policies) are tangible and somewhat easier to audit. Soft prevention controls (i.e., employee support programs, fraud awareness training, and management review of internal controls) provide overall assurance and contribute to a strong control environment but are not tangible and are more difficult to quantify or evaluate.

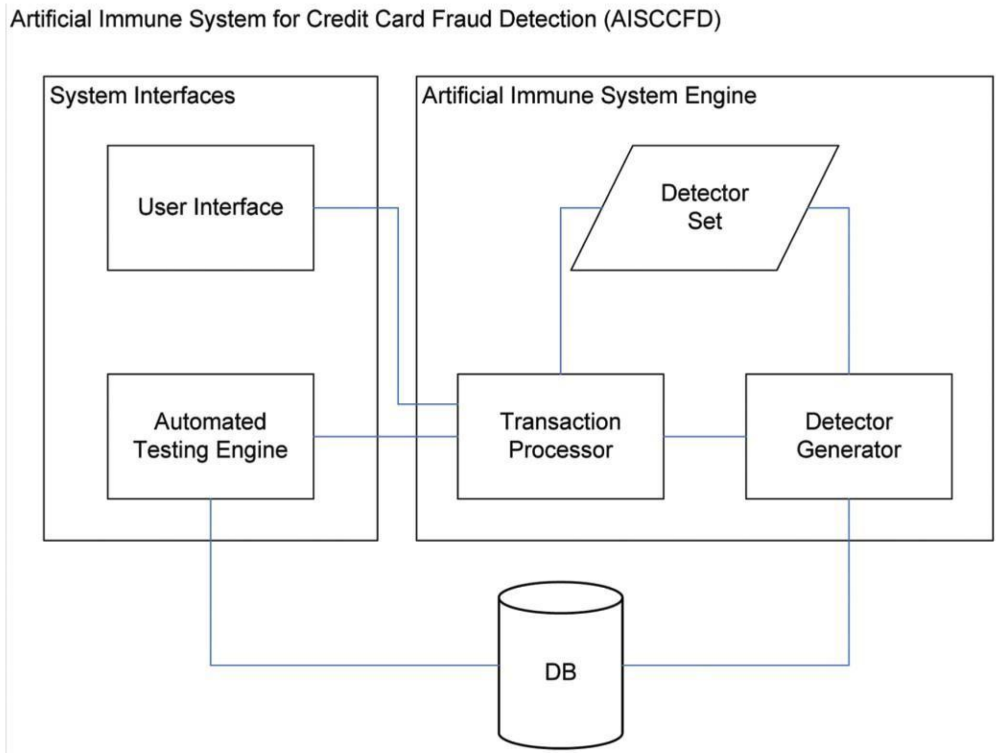
Company-wide fraud attitudes also play an important role in fraud prevention. Davis & Pesch (2013) developed a model of fraud in organizations that allowed an evaluation of the relative efficacy of mechanisms designed to prevent fraud. Their agent-based model (ABM) recognized the social processes underlying the formation of organizational norms and was designed to study the emergence of macro-level phenomena, such as a culture of fraud, from micro-level interactions, such as interactions between individuals within an organization and organizational variables. ABM also provided the additional advantage of allowing insight into fraud even when data in organizations are censored.

The Davis and Persch (2013) model involved two levels of employees, managers and staff, and two types of organizational attitudes, emulation likely and emulation unlikely. Their results suggested that reducing opportunity can limit the extent of fraud in an organization but a firm's culture and its staff's susceptibility to manager influence also play important roles in fraud dynamics. The model also indicated that auditors and others responsible for fraud risk or fraud detection and prevention should realize that fraud levels in a company may vary tremendously over time and that prevention and detection methods cannot be employed in a uniform manner across all types of organizations.

In the Association of Certified Fraud Examiners (ACFE) 2014 report, a most important finding was that the representative organizations indicated revenue losses of 5% because of fraud activity each year. This percentage resulted in similar findings in the ACFE's 2012 report which totaled almost $3.7 trillion if applied to the Gross World Product (GWP). Verschoor (2014) noted that the median loss was $145,000 which was a bit higher than 2012. In addition, the author noted more than 20% of the fraud incidents involved at least $1 million dollars' worth of losses.

Wong, et al. (2012) proposed an interesting comparison between human artificial immune systems and Accounting Information Systems' (AIS) fraud detection processes. The authors took techniques from the human artificial immune system for classifying natural and unnatural biological entities and utilized this classification model as an approach to online credit card fraud detection. The researchers described the features of the biological immune system and modified those characteristics so they applied toward AIS applications. Their model is demonstrated below in Figure 2.

Figure 2
ARTIFICIAL IMMUNE SYSTEM FOR CREDIT CARD FRAUD DETECTION (AISCCFD) SYSTEM



Financial Statement Fraud, the Fraud Triangle and a Meta-Model of Fraud

Albrecht and Albrecht (2008) suggest that fraudulent financial statements have many common characteristics, including the nature of the fraud, types of financial statement fraud, and how the fraud is committed. They examined the elements of the fraud triangle (perceived pressure, perceived opportunity, and rationalization) and propose that the elements are interactive. For example, the greater the perceived pressure or opportunity, the less rationalization will be necessary. They found that the most common methods used in the preparation of fraudulent financial statements are improper recognition of revenue, overstatement of assets, and understatement of expenses.

Albrecht, et al. (2008) built upon the fraud triangle by adding various factors that contribute to it. They added personal position, corporate position, compensation plan structure, and externally imposed expectations to perceived pressures. To perceived opportunity, they added external oversight and monitoring, internal monitoring and control, environmental complexity, and related parties. In addition, they added level of personal ethics, environmental ethics, need to succeed, and lack of knowledge or education to rationalization. They suggest that rules-based accounting standards (U.S. GAAP) lead to rationalization for financial statement fraud. Finally, they explain that if a client selects a questionable method of accounting that is not prohibited by GAAP, it is difficult for auditors to argue against using that method.

Dorminey, et al. (2012) proposed a meta-model of fraud and financially motivated crime. The meta-model combines the fraud triangle (pressure, opportunity, and rationalization) with Albrecht's triangle of fraud action which includes the act, concealment, and conversion.

Although the fraud triangle helps us understand why an individual commits fraud, the triangle of fraud action includes control points for the prevention, detection, or remediation of fraud. The meta-model builds on the fraud triangle and triangle of fraud action by identifying the pre-fraud state of the environment perceived by the potential perpetrator of a fraud and the post-fraud elements of the crime. Dominey, et al. (2012), suggest that the Meta model provides a framework for developing a unified coordinated antifraud environment.

Improper recognition of revenue is one of the most common methods used in the preparation of fraudulent financial statements. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) began a joint project in 2011 to improve accounting for revenue. Rosenhouse (2014) provides an overview of the new converged standard for revenue recognition. The FASB issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), at the same time that the IASB issued International Financial Reporting Standard (IFRS) 15, and Revenue from Contracts with Customers. Issuance of the two documents completes the joint FASB/IASB project on revenue recognition. Revenue from Contracts with Customers is a departure from the rules-based revenue recognition under prior U.S. GAAP. The converged standard outlines five steps for revenue recognition:

1. Identify the contract(s) with customers,
2. Identify the separate performance obligations in the contract,
3. Determine the transaction price,
4. Allocate the transaction price to the separate performance obligations, and
5. Recognize revenue when each performance obligation is satisfied by the entity.

Ryerson (2011) states that the new revenue recognition approach is based on an asset/liability model that defines revenue as a residual from recognizing and measuring increases in assets and decreases in liabilities. By using an asset/liability model, it is not necessary to define the earnings process. The asset/liability approach is consistent with the current definition of revenue for both the FASB and the IASB.

Financial Statement Fraud and Corporate Governance

Reidy and Theobald (2011) propose a multi-faceted antifraud program. It starts with a strong ethical attitude for top management. They emphasize the importance of skepticism on the part of management, the board of directors, and the audit committee. Finally, they stress the importance of communication for management, the audit committee, internal auditors, and external auditors.

Boyle, et al. (2012) propose that the internal audit function is well suited to work with members of a company’s board of directors to provide fraud awareness, education, and recommendations for both prevention and detection of fraud. They cite studies indicating that the Chief Executive Officer (CEO) or the Chief Financial Officer (CFO) were implicated in a high percentage of cases of fraudulent financial reporting, as high as 89% in one study. As a result, they recommend some key themes for discussion with a firm’s audit committee and members of the board of directors. Some of the more important themes are: (1) the audit committee should control selection, retention, and termination of the external auditor; (2) the external auditor should report to the audit committee not management; and (3) the audit committee should take the lead in resolving any disagreements between the external auditor and management. In addition, they recommended adding directors with industry experience or directors with both industry experience and accounting or supervisory financial expertise.

Beasley, et al. (2000) studied financial statement fraud that occurred during the late 1980s and the 1990s in three industries (technology, health care, and financial services). They found that the most common type of fraud for technology companies involved improper recognition of revenue. Asset fraud and misappropriation of assets were more common for financial services. Additionally, they examined the nature of corporate governance in fraud vs. no-fraud firms at the industry-specific level. They noted differences in the extent that audit committees exist and are independent and the extent that boards of directors are independent from management. There was less independence in the fraud companies than in no-fraud companies. Their findings also highlight differences in the number of audit committee meetings and the existence of internal auditors. Fraud companies had fewer audit committee meetings and less internal audit support.

Persons (2005) examined the relationship between the likelihood of financial statement fraud and five corporate governance characteristics. The five corporate governance characteristics were (1) audit committee consisting of only independent directors, (2) number of additional directorships of members of audit committee, (3) majority of board members is independent, (4) audit committee members with accounting or financial proficiency, and (5) independent directors comprise nominating committee. Persons found that financial statement fraud was less when the audit committee consisted solely of independent directors and when audit committee members were members of fewer other boards of directors.

Sharma and Iselin (2012) studied the association between financial misstatements, multiple-directorships, and the tenure of independent members of the audit committee, both pre- and post-Sarbanes Oxley (SOX). They found a positive relationship between financial misstatements and multiple directorships post-SOX. This is consistent with Persons’ findings in her study of the relationship between multiple directorships and financial statement fraud. Sharma and Iselin also found a positive relationship between tenure of audit committee members and financial misstatements post-SOX, suggesting that a continuing association with management could decrease their effectiveness in an oversight role.

Fraud Investigation and Data Loss

How can data losses be prevented during an investigation? Kardell (2007) notes that an investigation should begin by looking for any item that could be utilized in a computer forensic analysis (Carrier, 2013). Then, the investigator should look around the possible suspects’ work area for any type of digital equipment such as sync cables for cell phones, or digital musical devices which could be utilized to carry off numerous documents in digital format. The search should also include USB thumb drives and even power cords with no devices attached. Carrier (2013) also advises investigators to also look for Internet access cards and care should be taken to match the employee’s HR record as to devices assigned to the employee with the devices found in the work area.

Preserve the Data

There can be two schools of thought in regard to whether an investigator should shut down the computer to save data or make an attempt to save the computer’s temporary data. Some professionals prefer shutting down through Windows which Kardell (2007) terms it a graceful shutdown or pulling the plug from the wall. The author noted that the decision made on how to shut down the computer in order to save the most data would really depend upon the configuration of the computer. But the author notes that there could be malicious software on the computer hindering data saving techniques if the computer is not configured with standard tools and programs which the technology staff will normally install on all new computers or the programs might already be available on newer computers. After the data is preserved, investigators can utilize a program such as Access Data Forensic Toolkit (FTK) or Guidance Software Encase so that the computer data can be investigated without being destroyed.

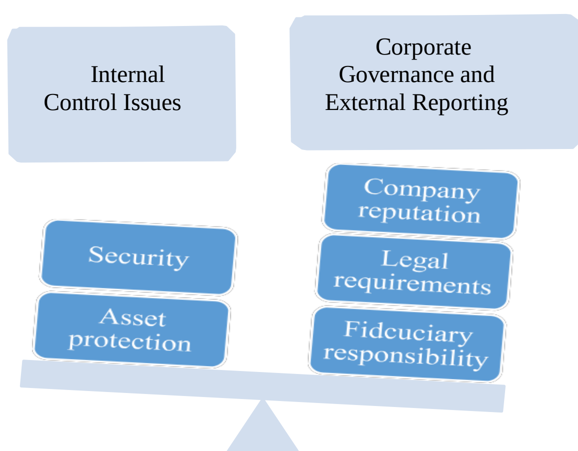
Agarwal & Medury (2014) argued that not only should appropriate internal controls be implemented, but noted the importance of Internal Audit and strict employment of regulations. The authors believe that regulators sometimes wait for something to happen and then make more law to deal with the issues, rather than the other way around. Johnstone, Chan, & Hertz (2011) note that companies can find themselves with a fraud issue or other negative incident and thusly change their corporate governance mechanisms or they may even change board of directors or other management staff leading to enhanced corporate governance endeavors.

SUMMARY AND CONCLUSION

Researchers indicate that the primary goal of corporate governance deals with balancing the interests of the many stakeholders in a company. Ilatotchev & Nakajima (2014) researched how corporate governance and organizational control could affect leadership strategy approaches while keeping in mind economic and social challenges facing the corporate decision-makers. The authors noted an important point that corporate governance can involve different levels within an organization and thereby any enhancement of corporate governance procedures should take this possible situation in mind. Governance structures typically identify the distribution of rights and responsibilities among different stakeholders and would include decision-making rules within the corporation (Ilatochev & Nakajima, 2014; Ramaswamy, 2005). Mukweyi (2010) noted that many times owners and/or managers presume responsibility for safeguarding interests of stakeholders whereby leaders within the organization may expend more effort toward maintaining operational and functional areas of the business which might cause a conflict in dealing with managerial fraud in that decisions made by leaders entrusted to run the organization could be made at the expense of stakeholder interest.

As demonstrated in Figure 3, Ramaswamy (2005) argues that organizations need to procure a centralized effort to monitor internal control's effectiveness while keeping in mind the importance of balancing internal control issues with corporate governance and external reporting activities.

Figure 3
MAINTAINING BALANCE



The authors believe that with the proper legal and corporate governance background, a fraud investigator could aid in management's adherence to the company code of ethics which would be reinforced with management's compliance behavior thereby reducing the incidence of fraudulent behavior.

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NEW GLOBAL CYBERCRIME CALLS FOR HIGH-TECH CYBER-COPS

Richard McMahon, University of Houston-Downtown
Martin S. Bressler, Southeastern Oklahoma State University
Linda Bressler, University of Houston-Downtown

ABSTRACT

Almost daily we see reports of cybercrimes, whether involving hacking into a company's data system and stealing millions of customer accounts or exposing yet another identity theft scheme. In 2013, there were 13.1 million victims in the United States of identity theft with losses totaling more than $18 billion and the $18 billion figure was actually a decrease of $3 billion from the previous year (Javelin Strategy & Research, 2014)! Both large and small businesses can be attacked and those attacks are not always by the typical hackers. Lately, companies have been besieged by ransomware, click-jacking, doxxing, phishing, pharming, and even mini-drones (Ikseu & Yongyun, 2015). Some authors assert that we are losing the cyber war and the fault is mostly ours (Gewirtz, 2014). Similarly, other authors believed the problems deal with our rush to put every possible device online without properly securing them first (Heaven, 2015).

INTRODUCTION

Javelin Strategy & Research (2014) reported that in 2013 there was a new victim of identity fraud every two seconds. In fact, according to that report, more than 13 million people were victims of identity theft that year with an $18 billion financial impact. Businesses also fall victim to various forms of cybercrime, often by way of email scams. In fact, in 2014 the Federal Bureau of Investigation's (FBI) Internet Crime Complaint Center (IC3) logged 2,417 complaints about compromised business email accounts that resulted in losses of $226 million (2014 Internet Crime Report). Cybercrimes (listed in Table 1) may include fraud, identity theft, theft of money or data (which could include patent or trade secrets), and malicious attacks using viruses (sabotage), sextortion, and even sometimes cyber-bullying (although this paper does not address that issue).

Farrell & Hurtado (2015) report that in 2014, JPMorgan experienced the largest cybercrime hack, part of a global criminal ring which stole data from 100 million financial services customers involving 75 companies bank and brokerage accounts (http://www.bloomberg.com/news/articles/2015-11-10/hackers-accused-by-u-s-of-targeting-top-banks-mutual-funds). The global nature of theses high-tech crimes call for a new approach by government, corporations and law enforcement with new methods and new technologies to thwart these attacks and dismantle the criminal enterprises.

In this paper, the authors examine some of the latest cybercrime threats and offer recommendations to thwart those crimes and stop cyber-criminals who use technology to steal from or cause harm to individuals and/or businesses alike.

New Cybercrimes Call for New Global Cyber-Cops

Cybercrimes are a global threat where criminals can be located anywhere around the globe as long as they have a computer with access to the Internet. Most cybercrimes are financially motivated but the form they take can vary. Increasingly, INTERPOL (2014) is becoming involved in hunting down the new types of cyber-criminals. One of the newest cybercrimes is sextortion, defined as sexual blackmail for money or sexual favors from individuals using sexual information such as photos, videos, or explicit messages stolen from their computers. The INTERPOL Digital Crime Center (IDCC), working with the Hong Kong Police Force, the Singapore Police Force and the Philippines National Police Anti-Cybercrime Group, identified more than 190 individuals working for organized crime groups operating out of the Philippines. This multinational enforcement operation, cooperating closely with Police Scotland, U.S. Immigration and Customs (ICE), Homeland Security Investigators (HIS), the Philippines Department of Justice Office of Cybercrime, and the UK's National Crime Agency CEOP Command, identified sextortion victims in Indonesia, Philippines, Singapore, the United Kingdom, Australia, Korea, Malaysia, Hong Kong, and the United States. The sextortion networks are simply out to make money no matter what damage they inflict on their victims.

Tompor (2015) brought to light another of the newest forms of cybercrime — holding data for ransom. Cyber-criminals use ransomware to invade computers, usually by sending an email with an attachment that an unsuspecting recipient opens which then infects and takes over the recipients' computer. Data, in the form of music, photos, or other computer files are the held by the cyber-criminal until the victims pay the ransom to get their data back. Individuals have been extorted for amounts ranging from $200 to $10,000 while business ransoms have been between $20,000 and $50,000. From April, 2014 to June, 2015 there were 992 complaints filed with the FBI and the victims reported losses over $18 million.

Cybercrime around the globe has become so sophisticated that underground organization calling themselves Darkode operates a secure website where criminals can buy, sell, or trade zero days, malware, credit card numbers, and trojans (Pauli, 2015). In July of 2015, the Federal Bureau of Investigation teamed up with the European Cybercrime Center's "Operation Shrouded Horizon" to shut down the site. The operation resulted in the arrest of 28 Darkode operators and administrators from 20 different countries, including the United States, Australia, and the United Kingdom (Pauli, 2015). Unfortunately, the Darkode crime forum was back online in less than two weeks – with even tighter security and by invitation only!

Kovacs (2015) reported that the Darkode site has operated for more than eight years and its use of individual Onion (layered like an onion) addresses gives Darkode administrators greater control over who has access to the service and helps protect their crime operation against outside hijacking attempts. However, even with such sophisticated security systems in place, Darkode users forgot security procedures and reused passwords that law enforcement agencies tracked and closed down the site (albeit temporarily closed).

Evans (2015) reports the world's biggest bank raid which cost more than 100 banks worldwide more than 650 million British pounds. (http://www.telegraph.co.uk/news/uknews/crime/11414191/Hackers-steal-650-million-in-worlds-biggest-bank-raid.html). The gang of hackers used computer viruses to infect bank computer networks and once inside the system, impersonated bank employees to transfer funds to dummy accounts. Farrell & Hurtado (2015) cite this as the largest cyber security breach ever, and O'Neill (2014) reported that 65% of U.S. households or small businesses have been affected by this attack.

(http://kernelmag.dailydot.com/issue-sections/headline-story/11224/the-10-biggest-hacks-of-2014/).

Minding your business

Neumann (2014) suggested that cloud computing could reduce some of the new risks currently encountered online, especially if the user's contract would be under a single operational administration such as when employing cloud storage. Cloud storage (or remote storage) can be considered similar to off-site backups utilized before the advent of cloud technology. Heaven (2015) noted that individuals need to become more technologically savvy because, for instance, using smart phones without understanding the technology involved might allow somebody else in China or Russia who knows exactly how smart phones work to use that knowledge against unsuspecting users. The author suggested that people should acquire a sense of cyber hygiene, which can be as simple as understanding that opening an attachment from someone you don't know (or someone you do know when you are not expecting a document from them) could contain a virus. This virus could not only affect the first person to receive the attachment but may also attack anyone receiving the email attachment.

Yes, your business is at risk. Contreras-Sweet (2015) pointed to the National Small Business Association's 2013 Small Business Technology Survey where 44% of small businesses reported being the victim of a cyber-attack, with an average cost to the business of about $9,000. Small businesses are especially vulnerable to cyber-criminals as small businesses typically carry data about employees, customers, as well as bank accounts, and they have fewer resources to defend themselves against cyber-attacks. But there are things you can do to reduce the risk of your business falling victim to cyber-criminals.

Contreras-Sweet (2015) provided five key steps recommended by the U.S. Small Business Administration that small business owners can take to reduce their vulnerability to cyber-attacks.

1. Protect against viruses, spyware, and other malicious code--be sure all computers have updated security software.
2. Secure your networks--your internet connection must have a secure firewall and encryption. Hide your Wi-Fi network and protect it with a secure password.
3. Educate employees about cyber-threats and hold them accountable--provide information to employees on ways to avoid exposing trade secrets or other confidential information.
4. Require employees to use strong passwords and to change them often-consider requiring multifactor identification.
5. Employ best practices on payment cards--for example, using computer chip credit cards rather than the older magnetic strip cards for payment processing.

Terminology

Click-Jacking

Concealing hyperlinks beneath legitimate clickable content which, when clicked, causes a user to unknowingly perform actions, such as downloading malware, or sending personal information to a website. Numerous click-jacking scams have been deployed via "Like" and "Share" buttons on social networking websites. Researchers indicated there can be other ways to use your browser options to maximize security (Rydstedt, et al. 2010).

Cyber Hygiene

Refers to steps that computer users can take to improve their cybersecurity and better protect themselves online (Heaven, 2015).

Cybercrime

Criminal activity or a crime that involves new technology, usually the Internet, a computer system, or computer technology to accomplish the following: identity theft, phishing, and/or other kinds of computer/technology-oriented crime.
(http://dictionary.reference.com/browse/cybercrime)
(http://www.gethackingsecurity.com/evolution-of-cybercrime/)

Denial of Service

A Denial of Service (DoS) attack is an incident in which a user or organization is deprived of the services of a resource they would normally expect. In a distributed denial-of-service, large numbers of compromised systems (sometimes called a botnet) will attack a single target.
(https://en.wikipedia.org/wiki/Denial-of-service_attack)

Doxxing

Publicly releasing a person's identifying information online without authorization. Caution should be exercised by users when sharing or posting information about themselves, their family, and their friends.
(http://www.thestar.com/news/insight/2015/08/16/whats-up-with-dox-the-troubling-history-of-an-online-scare-tactic.html).

Frame-Busting

The most common defense to Web framing attacks such as clickjacking which uses frames to hijack a user's web session. Frame-busting prevents a site from functioning when loaded inside a frame (Rydstedt, et al. 2010).

Mini-Drone/UAV

A drone is a powered, aerial vehicle that:

1. Does not carry a human operator,
2. Uses aerodynamic forces to provide vehicle lift,
3. Can fly autonomously or be piloted remotely,
4. Can be expendable or recoverable, and
5. Can carry a lethal or nonlethal payload

(https://en.wikipedia.org/wiki/Unmanned_aerial_vehicle#Definition_and_terminology)

Onion Routing

A technique for anonymous communication over a computer network. In an onion network, messages are encapsulated in layers of encryption.
(https://en.wikipedia.org/wiki/Special:Search?search=what+is+an+onion&go=Go)

Phishing

Trying to obtain financial or other confidential information from Internet users, typically by sending an e-mail that looks as if it is from a legitimate organization, usually a financial institution. It also typically contains a link to a fake website that closely resembles the real one (http://www.ask.com/web?qsrc=1&o=0&l=dir&q=phishing).

Pharming

A scamming practice in which malicious code is installed on a personal computer or server, misdirecting users to fraudulent Web sites without their knowledge or consent. Pharming has been called "phishing without a lure."
(http://searchsecurity.techtarget.com/definition/pharming)

Pretexting

Contacting a competitor under some pretext, such as pretending to be a customer to obtain pricing or other competitor information or, in some cases, pretending to be an employee in order to gather data, steal information or plant listening devices.
(http://dictionary.reference.com/browse/pretexting)

Social Engineering

In the context of information security, refers to psychological manipulation of people into performing actions or divulging confidential information via the phone, email, etc. or by enticing an individual to open an email and/or click on an attachment which would initiate theft of information or cause havoc with the user's system.
(https://en.wikipedia.org/wiki/Social_engineering_(security)

Zero Day

When copyrighted software is cracked on the same day it is released, hackers quickly spread the word across the Internet so that other hackers can take advantage of the security breach on the "Zero day."
(https://en.wikipedia.org/wiki/Zero_day)

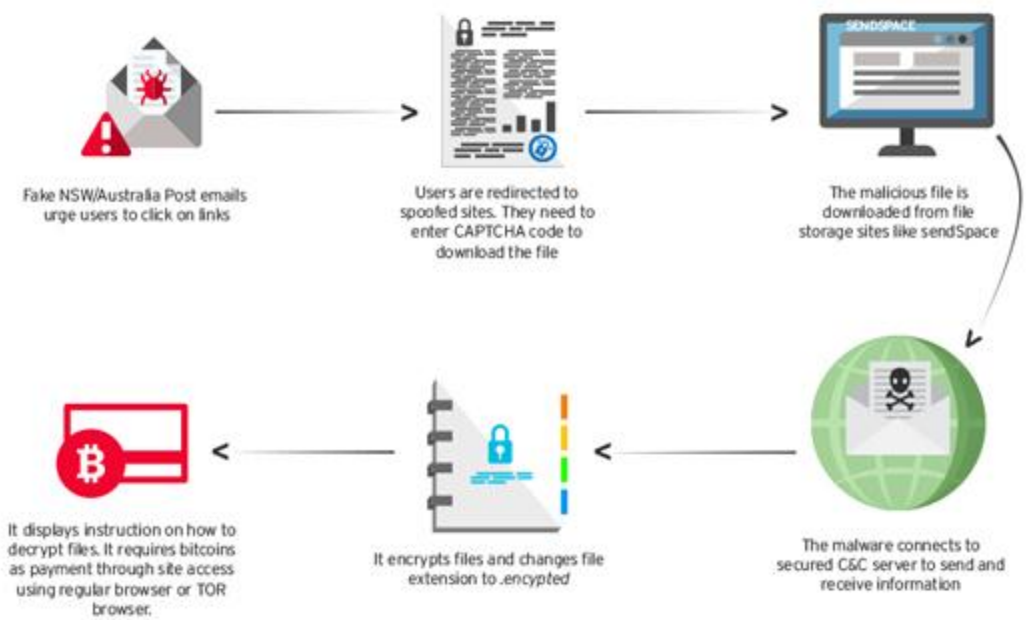
Ransomware

Recently, companies noted a new kind of attacks, ransomware, which typically involved a victim receiving an email containing a link or attachment (Pajares & Ke, 2015). The email utilizes social engineering to persuade the victim to click the link or open the attachment (usually a malicious file). In the "infection chain" example below, the authors Paul Pajares and

Christopher Ke (January 11, 2015 from http://blog.trendmicro.com/trendlabs-security-intelligence/torrentlocker-ransomware-hits-anz-region/) illustrate how that would happen.

The Infection Chain

Figure 1
INFECTION DIAGRAM FOR ANZ ATTACKS
(http://blog.trendmicro.com)



In effect, the perpetrator utilized several fake domains so that the receiver's SPAM check did not identify the email as SPAM. In 2015, Jay Yaneza, a Threats Analyst, noted in a security blog (http://blog.trendmicro.com/trendlabs-security-intelligence/defending-against-cryptolocker) that there can be ways to prevent this type of crypto-locker ransomware threat. Since this threat depends upon the success of the attacker's social engineering techniques, one preventive measure would be to never open an email from someone you do not know or expect to receive a communication. If the email is from someone you know, call them to ask if they sent the attachment. The second preventive measure would be to review the message for obvious errors such as misspellings or factual errors. Third, a preventive measure would be to utilize strict attachment blocking policy. Finally, a fourth measure would be to refrain clicking on links in email as a general rule, but the damage would be lessened if all important data could be backed up several times per week, weekly, or monthly (whatever time period would be appropriate for the individual business). In another words, how many days' data can you afford to lose (http://blog.trendmicro.com/trendlabs-security-intelligence/defending)?

Clickjacking

Another threat noted on the web was clickjacking (Huang, et al. 2012) and this type of attack can affect email, private webcams, and users' private information. The term clickjacking was first used in 2008 (Lemos, 2008). Clickjacking can also be referred to as a “user interface (UI) redress attack” which happens when a perpetrator uses more than one transparent or opaque layer to trick a user into clicking on a button or link on another page when they were intending to click on the first level page. Therefore, the perpetrator is "hijacking" clicks meant for the user’s page and routing them to another page, most likely owned by another application, domain, or both. Keystrokes can also be hijacked with what Rydstesdt, et al. (2010) indicates would be a carefully-created combination of stylesheets, iframes, and text boxes and the user can be led to believe he or she is typing in the password to her or his email or bank account, but instead will be typing into an invisible frame controlled by the perpetrator.

Huang, et al. (2012) believed that one defense against clickjacking called InContext could be initiated which is a form of frame-busting (Rydstedt, et al. 2010) and it ensures that users see all layers before clicking. InContext would essentially enforce context integrity to protect the user. The authors (Rydsstedt, et al.) conducted a user study on Amazon Mechanical Turk with 2,064 participants and found that utilizing InContext allowed a 43 – 98% success rate in deterring clickjacking attacks.

Doxxing

Crouch (2015) defines doxxing as online users making individuals’ private information public. Doxxing can include someone wishing retribution against an individual or individuals by attempting to share something a person might consider his or her own private business, but if exposed could cause shame on herself or himself or the individual’s family and friends. Eveleth (2015) related a story about Anna Merlan who received a strange email from Domino’s pizza about pizzas she ordered. She did not order any pizzas nor did she live at the address listed in the email. What happened to Merlan next could be compared to a human denial of service attack whereby in Merlan’s case, her email contained threatening messages, and her Twitter and Facebook accounts flooded with anonymous harassers.

When presidential candidate Donald Trump released U.S. Senator Lindsey Graham’s phone number to his audience at a campaign rally, it was a blatant example of doxxing. Doxxing is the strategic unauthorized sharing of someone’s personal information. Later in his campaign, Donald Trump became the victim of a doxxing treatment as Gawker published Mr. Trump’s personal phone number online (Dewey, 2015).

Eveleth (2015) believed there could be ways to prevent doxxing before it happens. The author noted that new hires should have digital security training on how to keep personal information private, including how to send and receive encrypted emails. In addition, all staff members should be warned that they should never utilize their personal email at work and that their work-related packages and letters should only be sent to the workplace and not to their home. Other authors suggested that Post Office boxes might be an effective way to protect privacy, and that management should be trained in the importance of recognizing web-based harassment and setting up anonymous reporting of such behavior (Mathews, et al. 2013).

Mini-Drones

Some of the threats to individuals can be computer and Internet issues. But new threats can also come from outside our computer screen. Unmanned Aerial Vehicles (drones) can also be used for spying, taking pictures, and even stealing data. Until recently, most drones have been utilized almost entirely by the military but now drones can be seen monitoring weather, maintaining border security and now also for commercial uses. Companies already utilize mini-drones to deliver packages and some drones can be fitted with expensive cameras (Graves, 2015; Hilaly, A. 2015; http://www.businessinsider.com/drone-delivery-could-be-reality-within-months-if-government-gets-out-of-way-2015-11) but drones can be used with good intentions or for unethical or illegal purposes (Knowles, 2015). But all is not lost: the same way hackers were deterred, researchers indicate that there can be counter-measures for drone incidents as well (Knowles, 2015; https://www.foreignaffairs.com/articles/2015-05-01/drone; Liu, et al. 2015).

The popularity of mini-drones persists. In the past, drones could be used to take pictures in a remote or dangerous place. Oil and Gas companies use drones to monitor pipelines, oil rigs, etc. Drones can be used to deliver packages (West, 2015). Drones could also be utilized for cybercrime purposes. Some min-drones with high definition cameras can take excellent videos and pictures from the air. In addition, drones can fly over buildings with equipment to copy/transfer computer files and other proprietary information. In addition, many of the more expensive units ($200+) can easily be controlled by a smart phone, tablet, or computer. Although mini-drones could be noted to be exclusively utilized by the military, individuals can buy these machines easily on the Internet. The prices continue to decrease and an individual can purchase a mini-drone for $24.95 on Amazon.com (Liu, et al. 2015; Graves, 2015).

Drone technology is not foolproof, however. There can be several ways to deflect or disarm mini-drones hovering over home or business. One company created a counter measure UAV (drone) system which can detect a drone, fuse the sensor data and essentially jam the drone's system which would in turn, interrupt its navigation system. Knowles (2015) noted that a European company, Plath GmBh created an electromagnetic fence which surrounds the area a business would like to protect and prevent drone cyber-spying.

Phishing & Pharming

In phishing, a perpetrator sends out innocuous emails which appear to be sent by legitimate websites and/or businesses in an attempt to gain personal and financial information sometimes through social engineering enticing the victim to click on a hyperlink (http://www.ask.com/web?qsrc=1&o=0&l=dir&q=phishing). If someone clicks on the hyperlink in the message, they will be sent to a fake website (looking very much like the legitimate one) and if they enter their user name and password the attacker will steal their information (http://searchsecurity.techtarget.com/definition/social-engineering). Kim and Cho (2015) noted that most browsers utilize an URL filtering method which would be able to detect a false URL from a blocked phishing server listing.

However, in pharming, the attack is not focused on single victims (http://searchsecurity.techtarget.com/definition/pharming). Instead, many individuals can be affected. For example, a code can be sent in one email which would change the local host file on a personal computer. These host files will thus be compromised and will then take the victim to a fake web site - even when the victim types in a correct Internet address or clicks on a legitimate (but compromised) bookmark. Some virus protection programs can find and correct this corruption, but the problem can and will return unless such victims alter their Internet browsing practices (https://en.wikipedia.org/wiki/Pharming).

To date, the best way to prevent pharming requires individuals to ensure they use secure web connections (HTTPS) when they do their online banking and other private and confidential Internet logins (Kim, I. and Cho, Y., 2015). The HTTPS connections should only accept the valid public key certificates issued by trusted sources. In addition, "active cookies" could be utilized as a server-side detection tool. Kim and Cho (2015) also suggested a hash-based password authentication protocol and because such an authorization process would not use encryption keys and not need higher-level computational resources, this process would also work for wireless and smart-phones.

Hi-Tech Cops Tackle High-tech Crimes

In May of 2000 the FBI established the Internet Crime Complaint Center (IC3) and since that time the center has logged more than 3 million complaints (2014 Internet Crime Report). However, the problem is likely much larger than it appears since the FBI estimates that only 15 percent of fraud victims file a complaint and not all those who do complain file through IC3.

According to the 2014 Internet Crime Report, one of the most common Internet crimes reported to the FBI involves automobile (including trailers) fraud in which a consumer locates a vehicle on a website, typically an unusually good vehicle at well-below-market value (https://www.fbi.gov/news/news_blog/2014-ic3-annual-report). The fraudulent seller typically indicates that they must sell the vehicle quickly either because they are relocating for work or being deployed by the military. The seller refuses to meet in person but has the buyer wire the money to a third-party to make the sale appear legitimate. The buyer eventually learns that the vehicle never existed but the lesson only comes after the transferred money is long gone.

Another common scam reported by the FBI involves a perpetrator impersonating, by phone or over the Internet, someone from a government agency such as law enforcement, the local tax office, or sometimes even the Internal Revenue Service (2014 Internet Crime Report, https://www.fbi.gov/news/news_blog/2014-ic3-annual-report). The perpetrator thus pretends to represent someone in authority and demands immediate payment to the government agency, usually the overdue payment amount claimed is due to purported unpaid taxes. Other similar scams involve real estate, credit reports, or romance. One of the common threads is the use of social media to facilitate criminal Internet activity.

The FBI views Internet crime as an intricate puzzle and has developed a strategy to defend against cybercrimes (2014 Internet Crime Report, https://www.fbi.gov/news/news_blog/2014-ic3-annual-report). Figure 2 below shows the process the FBI uses when combating Internet crime.

Figure 2
THE FBI PROCESS FOR COMBATTING CYBERCRIME, 2014 INTERNET CRIME REPORT

SUMMARY AND CONCLUSION

The message is crystal clear. We are in a new world where criminals are not simply breaking into our houses or places of business – and the crimes they commit are not usually committed by local hoodlums. Instead, high-tech criminals can be located anywhere around the globe can find ways to access information on your home or business computers to steal your identity, your money, or your otherwise private information.

What should also be clear is that the crimes these tech savvy criminals unleash all around us are getting more and more sophisticated. We need continuous and ever-expanding protection from the list of cybercrimes with their unusual names. Individuals and businesses alike may have become complacent thinking they understood the likes of viruses, worms, trojans, hackers, scam artists, and maybe even identity theft. However, those same individuals and businesses now need to become even more vigilant as they arm themselves with defense mechanisms to avoid financial, physical, or emotional damages caused by a new onslaught of cyber-based attacks with names like ransomware, click-jacking, doxing, phishing, pharming and even sextortion.

There are various counter-measures including firewalls, virus-protection software and encrypting files that can be deployed to defend against this cyber-onslaught but a strong defense requires effort and commitment. Effort is required to keep up with the latest technology and develop strategies to protect your information while commitment involves having the will to devote resources (finances and personnel) to defend against cybercrimes. Failing to commit to a strong defense against cyber-attacks could cost you more money (possibly millions of dollars) and maybe even result in the complete loss of your business.

Table 1
FINANCIAL RELATED CYBERCRIMES

Fraud	**Computer Intrusion**	**Masquerading**	**Smurf Attack**
Identity Theft	**Theft of Money or Data**	**DoS Attack**	**Logic Attack**
Intellectual Property Theft	**Illegal Online Sales** (sex, drugs, weapons)	**Data Diddling** (altering raw financial data)	**Email bombing**
Sabotage	**Sextortion**	**Salami Attack** (small, hard to detect changes)	**Cyber espionage**
IRC Crime (Internet Relay Chat)	**Computer intrusion**	**Password cracking**	

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EXPLORING THE LEGALITY OF THE LUCRATIVE WORLD OF FANTASY SPORTS

Debra D. Burke, Western Carolina University
Bobby Philip Meek, University of Arkansas
John M. Norwood, University of Arkansas

ABSTRACT

This paper explores the gambling activities arising from Fantasy Sports Leagues, in particular the laws associated with these activities, and the gambling behavior of college students within these leagues. The paper begins with an investigation into the development of the fantasy sports industry. It then examines the Unlawful Internet Gambling Enforcement Act (UIGEA) which prohibits gambling enterprises from accepting payments (bets) over the Internet that would be unlawful under federal or state law, but specifically excludes fantasy sports under the federal gambling statutes. Because the UIGEA allows states to impose their own restrictions, however, the paper next surveys state laws and examines whether or not wagers on fantasy sports would be illegal. Finally, the paper reports on a survey of college students at a major Southeastern Conference university regarding their Fantasy Sports behavior.

INTRODUCTION

"If you bet on a horse, that's gambling. If you bet that you can make three spades, that's entertainment. If you bet cotton will go up three points, that's business. See the difference?"
Blackie Sherrod, legendary Texas Sports Columnist

Contrary to popular belief, Fantasy Football was not the first fantasy sport to be played. The first modern fantasy sport to be played was Fantasy Baseball, invented by a group of journalists who wanted to test each other's knowledge of sports in 1980. The league came to be called "The Rotisserie," and employed the same basic principles that comprise leagues today: a league commissioner, a group of participants (players), team names, the drafting of players, and a statistical scoring system. The basic principle behind the league was to create a system to gauge players' sports knowledge throughout the season. This league circulated throughout late 1980s via regional newspapers such as the L.A. Times, N.Y. Daily News and Chicago Sun-Times, prompting readers to create their own fantasy leagues (Holleman, 2006). Through the Internet in the nineties, fantasy players were able to create leagues through online providers, further growing the industry.

While the rules of fantasy leagues can vary greatly, participants (players) generally are set up through an online provider via a league commissioner. Participants join the league and a draft is held prior to the commencement of the season. A league usually has anywhere from eight to sixteen teams. Typically, in season long fantasy, players will be assigned a draft pick and this will determine their order of choosing players. Teams then play each other head to head throughout the season. Each week they submit their starting lineups, strategizing on what players to select for the week based on various factors: what team they are playing, the weather, injury status, etc. Each week the winner is determined by a scoring system that is determined by the player's performances for that week. Towards the end of the fantasy season, the top winning teams then go to a series of playoff games of single elimination. The winner of this playoff series is crowned the league champion.

Today, there is nearly a fantasy league for most every sport — football, basketball, stock car racing, golf, hockey, and more. Fantasy sports continue to grow yearly and people are spending more and more time playing. The growth of the industry has given way to additional services that players can use to gain an edge. Players can now insure their players through *fantasyplayerprotect.com*, give the league's prize money to *leaguesafe.com* for safekeeping, and seek advice from *rotowire.com*. If there's a dispute, no problem. Go to Sportsjudge.com "Where Fantasy League Disputes are Resolved" by real lawyers. FX has even created a comedy called *The League* that follows a group of friends throughout their fantasy season.

To keep things competitive, 46.9% of Fantasy Sports players pay league fees according to the Fantasy Sports Trade Association. For Fantasy Sports, the idea that the winner of a fantasy league will be the one with the most knowledge of sports gives credence to the idea that Fantasy Sports is a game of strategy, not a game of luck; this perspective is also why current regulations in many states allow placing wagers in leagues as long as certain conditions are met.

Over the years, fantasy sports have continued to evolve, with the largest growth coming lately from daily fantasy leagues. The most popular providers, "FanDuel" and "DraftKings" are revolutionizing fantasy sports. Unlike traditional fantasy leagues, daily leagues last a day or a week. They offer the same sports as traditional fantasy leagues, but are governed by different rules. Rather than a typical draft where each player has to wait their turn to draft a player, in daily leagues you choose players based on a salary cap, allowing multiple participants in the league to have the same player. These leagues also differ in the number of entrants: there is no maximum number of players in a given contest; although, per regulations, the prize money must stay the same.

SIZE OF THE INDUSTRY

Fantasy sports have created a unique way to inspire people to watch their favorite sports with greater interest. Professional leagues also have benefitted because sports betting encourages people to follow sports and increases television ratings (Bernard, 2013). Daily sports are enhancing the way sport enthusiasts test their skills against other players. While testing their skills for bragging rights can be exciting, the thrill of taking home a grand prize is even greater, which is why most season-long and daily fantasy leagues have entry fees.

Fantasy sports have experienced substantial growth in the number of users since 2003. The Fantasy Sports Trade Association (FSTA) estimates that 41.5 million people played fantasy sports in the USA and Canada in 2014, up from 500,000 in 1988 and 15.2 million in 2003, or an 11% compounded annual growth over the past twelve years. The FSTA estimates that roughly 46.9% of fantasy sports players spend $111 per 12-month period. Fantasy players are spending around 8.67 hours per week participating in fantasy sports and 30% of players are using additional websites to obtain information, spending $656 million a year for informational materials.

This usage supports the notion that players are doing their due diligence as players to formulate a strategy for their fantasy teams, enhancing the idea that fantasy sports is a game of skill and not gambling based on chance. Some statistics from the FSTA reveal valuable insights into the world of the typical fantasy sports player. As one would assume, the most popular fantasy sport is football, capturing 69.4% of total fantasy players. Fantasy sports players are predominately male (80%), educated (78.1% have at least a college degree), Caucasian (89.8%), and have an average age of 34. They are well-versed in the world of fantasy sports and average 9.51 years in fantasy sports. They are sports fanatics, spending 17.89 hours consuming sports per week.

According to Zack's Equity Research, the largest providers of traditional fantasy sports are Yahoo (18%), ESPN (13%), and CBS Sports (7%). These providers offer free to play leagues or paid leagues with prizes, provided you are a resident of certain states. For example, CBS offers five different fantasy leagues with various entry fees and prizes. ESPN and Yahoo offer similar paid leagues, both public and private, with cash prizes as well as gift cards in the case of ESPN.

While the traditional fantasy leagues have predominately been seen as a hobby, not a means of making money, the daily leagues have attracted a market segment that is looking to test their knowledge for big money. Relatively new, the daily leagues have created the easiest way for fantasy players to take home large amounts of money in a given week. FanDuel has managed to raise $88 million in equity with a business model based on fantasy sport wagers. These daily sports sites take in entry fees, give out prizes, and keep the excess as earnings. FanDuel has gone from $1,356,459 and 3,158 participants in the first quarter of 2011 to $370 million and 1 million participates in the fourth quarter of 2014, roughly a 42% compounded annual growth rate per quarter since 2011.

FanDuel has paid out $600 million to date and currently offers 30 thousand daily leagues with $20 million in weekly contest payouts. While DraftKings does not disclose their financial data, they assert on their website that there will be "over 1 billion guaranteed in prizes this year." What is even more impressive about these daily leagues are the massive tournaments that they host. DraftKings is hosting a $2 million Fantasy Basketball World Championship in 2015, while FanDuel hosted a $10 million fantasy football tournament with a $2 million first prize in Las Vegas. In order to win the big prize money, participants in daily leagues can pay an entry fee ranging from 25 cents to $5,000. Because of regulations to be discussed subsequently, the prizes for these tournaments are not based on the dollar value of the entry fees or number of participants that have entered.

These daily leagues are being seen as the future of the fantasy sports industry and large providers are recognizing their impact. FanDuel and DraftKings have seen equity investments from traditional fantasy sports providers, receiving capital from ESPN, Yahoo, and NBC. They are also lobbying NFL and NBA teams for sponsorships. For example, the Los Angeles Clippers announced a partnership with DraftKings to help with "engaging our fan base through this new partnership." FanDuel has seen partnerships with the Brooklyn Nets, Chicago Bulls, Dallas Mavericks, New York Knicks, and the Orlando Magic.

When selecting which daily site to use, 48% of players go with the site they trust. This tendency explains why FanDuel and DraftKings continually stress their legitimacy through advertising. DraftKings homepage declares: "DraftKings is based in the USA and is 100% legal" along with "safe 100% secure" and "as featured in… The Wall Street Journal, the Boston Globe, Forbes." Because daily fantasy sports is a new thing, the daily leagues are spending substantial amounts on advertising to establish their legitimacy. FanDuel employs testimonials of various participants to enhance the idea that it is a way for the average person to win money playing fantasy sports. Both DraftKings and FanDuel continuously offer deals to attract customers and increase their market share. DraftKings offers a "Plus 100% deposit bonus" and FanDuel offers a "Money Back guarantee. Love it after your first league or your money back." The main question that comes to mind with these huge payouts on daily sports, as well as the entry fees in the traditional leagues, is whether or not the wagers are legal.

THE LAW AND GAMBLING

Historically, gambling contracts were considered illegal bargains and unenforceable as a violation of statutory law or as being against public policy. Public policy generally is discernable from statutory pronouncements; however, courts may strike down agreements as being against public policy in the absence of statutory guidance (Williams v. Walker-Thomas Furniture Co., 1965). The typical concern proffered for why paying consideration for a chance should be an illegal bargain, and for why gambling which is not state sanctioned should be illegal, centers around concerns for morality and the notion that gambling is a vice which can produce societal harms (Towfigh, Glockner & Reid, 2013). One justification for prohibitions on wagering asserts that gambling increases the incidence of crimes that result from compulsive gambling behavior (Davidson, 2002). Additionally, the social and moral questions raised by the spread of gambling include potential increases in personal bankruptcies, along with pathological and underage gambling (Conon, 2009). In general, it is argued that statutes regulating gambling are necessary to protect public morals or to maintain public order (Hollander, 2015).

Given the amount of money that is won/lost playing fantasy sports, it is no wonder people question whether or not the entry fees should be considered illegal gambling. Opponents of fantasy sports argue that betting on fantasy sports is no different than any other form of unlawful wagering. Proponents of fantasy sports argue that fantasy betting is a game of skill, pointing to the expertise of the players and the time spent formulating strategies. Public policy reasons concerning the dangers emanating from gambling such as addiction and the exploitation of the human passion for games are often offered to justify regulation; however, distinguishing between games of chance and games of skill does not necessarily differentiate between dangerous and harmless games (Towfigh, Glockner & Reid, 2013).

Today, federal and state statutory law regulates the gaming industry and provides criminal penalties for violations. On the civil or contract side of the ledger, if the wager on fantasy sports is illegal under those laws, then both fantasy sports leagues and credit card companies would face uncertainty in collecting gambling debts, and fantasy sports contestants might have difficulty collecting if a fantasy sports provider refused to award a prize to a winning contestant (Davidson, 2002). The legality and regulation of online gambling in general, and with sports gambling in particular, remains controversial. Arguably, there are deficiencies in federal law and there is need for a new model for dealing with sports wagering, particularly over the Internet (Cabot, 2010).

Some observers claim that online gambling should be legalized because of the potential tax revenue available for state and federal governments. While the advent of online gambling should not strip the states of the ability to determine if legal gambling occurs within their borders, the federal government may be in a better position to establish a national framework and regulate the market (Warshaw, 2014). Additionally, commentators assert that because tax revenue from Internet gambling is tempting to states, federal regulation is needed to clarify existing federal law to set forth minimum standards and establish procedures for the licensing of Internet gambling (Miller, 2014). Other critics of the current system contend that clearly defining unlawful Internet gambling and broadening the criminalization of the activity to reach both operators and participants is a preferable approach to proposals that call for regulation and taxation (Conon, 2009). The following sections details current federal and state laws regulating wagering.

FEDERAL REGULATION OF THE GAMING INDUSTRY

There are several federal laws that affect the gaming industry and fantasy sports that providers must consider. For example, the *Interstate Wire Act of 1961* declares it is illegal for a business to assist or transmit illegal wagers and sets forth the penalties for the transmission of wagering information. Specifically, the Act provides that people engaged in the business of betting or wagering who knowingly use "a wire communication facility for the transmission in interstate or foreign commerce of bets or wagers or information assisting in the placing of bets or wagers on any sporting event or contest, or for the transmission of a wire communication which entitles the recipient to receive money or credit as a result of bets or wagers, or for information assisting in the placing of bets or wagers, shall be fined not more than $10,000 or imprisoned not more than two years, or both" (18 U.S. Code § 1084(a) (2015)). Because wire communications include the Internet, a fantasy sports provider which was deemed to be conducting unlawful gambling could be subject to the fines and penalties under the Act. In 2011 the Department of Justice issued an opinion stating that the Wire Act applies only to bets on sports events and races, thereby allowing state to authorize intra-state online games providing that gambling is legal under state laws (Rose, 2013).

The *Illegal Gambling Business Act of 1970* is broader than the Wire Act of 1961 in that it includes any illegal gambling activity whereas the Wire Act only includes illegal gambling activities that use wire communications. It declares that "whoever conducts, finances, manages, supervises, directs, or owns all or part of an illegal gambling business shall be fined under this title or imprisoned not more than five years, or both… (2) "gambling" includes but is not limited to pool-selling, bookmaking, maintaining slot machines, roulette wheels or dice tables, and conducting lotteries, policy, bolita or numbers games, or selling chances therein" (18 U.S. Code § 1955(a) & (b)(4) (1915)). The Act describes an illegal gambling business as one in which it: "(i) is a violation of the law of a State or political subdivision in which it is conducted; (ii) involves five or more persons who conduct, finance, manage, supervise, direct, or own all or part of such business; and (iii) has been or remains in substantially continuous operation for a period in excess of thirty days or has a gross revenue of $2,000 in any single day" (18 U.S. Code § 1955(b) (2015)). This Act exempts businesses that do not have gross revenues over $2,000 in any single day, and most fantasy providers would meet that threshold. If the providers were found to violate state gambling laws, they would be subject to prosecution under the Illegal Gambling Business Act of 1970, as well.

The *Professional and Amateur Sports Protection Act* (PASPA), was passed after lobbying efforts from the professional sports industry. PASPA makes it is illegal for a business to conduct gambling activities that are based on amateur or professional athletes. PASPA declares that it is unlawful for a governmental entity or a person to "sponsor, operate, advertise, or promote, pursuant to the law or compact of a governmental entity, a lottery, sweepstakes, or other betting, gambling, or wagering scheme based, directly or indirectly… on one or more competitive games in which amateur or professional athletes participate…" (28 U.S.C. § 3702 (2015)). While the law has been criticized as an invalid regulation of interstate commerce by Congress (Roeske, 2014) the Act was upheld by the U.S. Court of Appeals for the Third Circuit in a challenge brought by New Jersey (NCAA v. New Jersey, 2013). If a fantasy provider's league was deemed to meet the elements to be considered gambling or wagering, it could be subject to prosecution under the statute. Because daily leagues place such a high emphasis on entry fees and payouts, they could be at more risk to be considered wagering and be subject to sanction.

The *Travel Act of 1961* sets forth fines and punishments for violations of unlawful activities. The Act provides criminal penalties for using any facility of interstate or foreign commerce to "(1) distribute the proceeds of any unlawful activity; or (2) commit any crime of violence to further any unlawful activity; or (3) otherwise promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity (18 U.S.C. §1952(a) (2015)). The Act further declares gambling to be an unlawful activity if federal or state laws are violated (18 U.S.C. §1952(b) (2015)). Under the Travel Act, fantasy providers need to be careful in accepting and distributing interstate/foreign league proceeds as well as transmitting information that facilitates illegal gambling activities, such as conducting leagues for participants to illegally gamble. If fantasy leagues were found to be gambling activities, providers would be violating the Travel Act when distributing the proceeds, and for facilitating unlawful activity. Because providers use preseason reports, weekly reports, player rankings, fantasy statistics and more, they could be considered facilitating illegal gambling activities in violation of the Travel Act. For example, in *United States v. Miller* (1967), a federal appeals court found that tickertape and blackboards used in an establishment were facilitating illegal gambling operations, even though the establishment did not create and operate the illegal gambling pools. The court stated that the ticker need not be essential to the gambling operation; it need only facilitate an illegal gambling operation.

Finally, the *Interstate Transportation of Wagering Paraphernalia Act of 1961* makes it illegal for an entity to knowingly conduct interstate gambling. The Act declares: "Whoever, except a common carrier in the usual course of its business, knowingly carries or sends in interstate or foreign commerce any record, paraphernalia, ticket, certificate, bills, slip, token, paper, writing, or other device used, or to be used, or adapted, devised, or designed for use in (a) bookmaking; or (b) wagering pools with respect to a sporting event...shall be fined and/or imprisoned for not more than five years or both" (18 U.S. Code § 1953(a) (2015)). Fantasy providers could be in violation if their gambling activities are illegal. However, the act provides an exceptions in states where gambling is legal. Also, fantasy providers would be exempt if state statutes do not consider fantasy leagues to be gambling.

All of these federal statutes potentially impact fantasy sport operations. However, the federal law most pertinent to fantasy sports is the *Unlawful Internet Gambling Enforcement Act* (UIGEA). This statute was passed in 2006 to prohibit gambling businesses from accepting payments (bets) that involves the use of the Internet and that is unlawful under any federal or state law (31 U.S. Code § 5362 (10)(a)). Regulations promulgated pursuant to the Act require participants in payment systems to have controls in place to prevent the processing of prohibited transactions (31 C.F.R. Part 132).

Simply stated, Congress chose to prohibit financial institutions from allowing payment through their systems for prohibited activities, that is, internet gambling. This control method was recommended by the National Gambling Impact Study Commission, which found that internet gambling was causing debt collection problems for insured depository institutions and the consumer credit industry, and that new mechanisms for enforcing gambling laws were necessary, traditional law enforcement mechanisms being found inadequate. Section 5364 of the U.S. Code requires participants to have policies and procedures in place to identify and prevent restricted transactions, such as credit cards, electronic fund transfers, checks, or the proceeds from any other transaction. Civil remedies for violations of the Act include injunctive relief, while criminal penalties include fines and imprisonment. The UIGEA has been upheld against a challenge of unconstitutional vagueness (Interactive Media Entertainment & Gaming Association v. United States, 2009). However, arguably the Act imposes excessive burdens on financial institutions and fails to take into account that online gambling providers may relocate overseas beyond the reach of regulation (Moran, 2010-11).

The Act specifically spelled out what is considered a bet or a wager. A bet or wager means staking or risking something of value upon the outcome of chance with the understanding that the person or another person will receive something of value in the event of a certain outcome, including the purchase of a chance to win a lottery or other prize that is predominately subject to chance (31 U.S. Code § 5362(1)). Finally, the definition also includes any instructions or information that results in the movement of funds by the "bettor or customer in, to, or from an account with the business of betting or wagering" (31 U.S. Code § 5362(1)(d)). The UIGEA specifies that transactions, including those involving fantasy sports, would not be considered a bet or wager as long as: 1) the prizes are determined before the games and not determined by the fees collected; 2) there is a method for assessing the knowledge and skills of the players, which is determined by a statistical scoring system across multiple sporting events; and 3) no winning outcome is based on the score of any one team or a single athlete.

Thus, providers have attempted to design their services to meet the requirements of the UIGEA. First, they have created leagues where the prizes are determined in advance. For example, as mentioned previously, CBS predesigned leagues have specific league champ prizes.

These prizes do not change, are not influenced by the number of entrants, and are disclosed in advance. Thus, the "Elite League" will have a league champ prize of $5,000 no matter what transpires with registrants. But how can the leagues guarantee a piece of the pie if they cannot change the entry fees charged or the prize given? For example, if a provider creates a fantasy league that guarantees a $25,000 payout, what guarantees that they will have enough entrants/entrance fees to cover the prize?

In the case of the traditional providers, the leagues are often quite small, usually just ten teams. However, the daily leagues have varying tournaments with small or large prizes and an unlimited number of participants. Therefore, the daily leagues are much more reliant on enrolling a sufficient number of participants to ensure that they cover the prizes of their leagues. If the leagues pass the breakeven point between entry fees and prizes, the overage will be profit because they are legally obligated not to change the prize money after the creation of the league. Most fantasy league players are oblivious to this regulation and wonder why there are $20,000 in entry fees but only $10,000 in prizes, but in essence the provider is rewarded for taking the risk that there will not be enough entries for a given tournament.

Secondly, the UIEGA requires that there be a method of assessing the knowledge and skills of the players that is determined by a statistical scoring system across multiple sporting events. For this reason Fantasy Leagues employ precise scoring systems in order to determine points. The stipulation that the scoring system should be across multiple sporting events can be illustrated by the daily leagues. Both FanDuel and DraftKings were unable to create a daily tournament for the Superbowl because it is a single scoring event. If they had created a daily league for the big event, it would have violated the requirement that the outcome be dependent on multiple sporting events.

Finally, the third requirement is that no winning outcome is based on the score of any single team performance or any single performance of an individual athlete. The first part of this requirement is why a fantasy player cannot draft his fantasy team from a single real-world team, i.e., players cannot have their entire team composed of the Dallas Cowboys, because this configuration would result in the outcome being based solely on the performance of the Dallas Cowboys. The second part of the requirement is why fantasy leagues have a diversified lineup of players. The typical fantasy football lineup has 1 quarterback, 2 running backs, 2 wide receivers, 1 flex RB/WR/TE, 1 tight end, 1 kicker, and one defense (although this lineup can change with varying league rules). This setup allows for the outcome of a fantasy match to be the culmination of the efforts of individuals, not actual teams. If a fantasy league with an entry fee were created that required teams to have only one player, then this requirement would be violated. Nevertheless, daily fantasy sports leagues appear to be more analogous to sports betting than to traditional fantasy sports leagues because chance, as opposed to skill, seems to be the dominant factor when deciding a winner, which could make participation a form of sports betting illegal under the UIGEA (Trippiedi, 2014).

REGULATION BY STATES

Some states track the spirit of the UIGEA in regulating fantasy sport leagues. For example, in 2015, the Kansas legislature excluded fantasy sports leagues from the definition of a "bet" if the league meets certain conditions. To be excluded “(1) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants; (2) all winning outcomes reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individual athletes in multiple real-world sporting events; and (3) no winning outcome may be based on the score, point spread or any performance or performances of any single real-world team or any combination of such teams or solely on any single performance of an individual athlete in any single real-world sporting event” (Kan. Stat. Ann. §21-6403(d) (2015)).

Nevertheless, state law does not need to adopt the paradigm established under federal law. Although the UIGEA excludes fantasy sports from violating federal gambling statutes, states can still impose their own restrictions. The UIGEA specifically provides that “the term ‘unlawful internet gambling’ means to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State laws in State or Tribal lands in which the bet or wager is initiated, received, or otherwise made” (31 U.S. Code § 5362(10)(A) (2015)).

Most states define gambling similar to the definition declared by Article VI of the Utah Constitution: "Gambling means risking anything of value for a return or risking anything of value upon the outcome of a contest, game, gaming scheme, or gaming device when the return or outcome is based upon an element of *chance* and is in accord with an *agreement* or understanding that someone will receive *something of value* in the event of a certain outcome” (emphasis added). Therefore, to be considered gambling in the majority of states, three elements must be satisfied: exchange of consideration, reward, and chance.

Consideration can be defined as “quid pro quo,” meaning something for something, or a mutuality of obligation (Restatement (Second) of Contracts § 71). In the context of gambling, most courts have defined consideration as providing something valuable (i.e., money) for the chance of greater winnings, while a minority of courts have found consideration to involve any legal detriment for the chance to win a prize (Edelman, 2011). The element of reward can be viewed as the prize of winning a bet, generally a tangible item. The third element, chance, is where state laws differ from federal law when it comes to fantasy sports. Chance is something that happens unpredictably. Courts have ruled that a game of chance is “such a game as is determined entirely or in part by lot or mere luck, and in which judgment, practice, skill or adroitness have honestly no office at all, or are thwarted by chance,” whereas a game of skill “is one in which nothing is left to chance, but superior knowledge and attention, or superior strength, agility and practice gain the victory” (State v. Eisen, 535, 1972). In other words, chance can be considered the luck element. But states differ on how significant the element of chance/luck must be. The four tests that are generally used to test for chance are: the predominance test, the material element test, the gambling instinct test, or the any chance test (Cabot & Csoka, 2007).

The “predominance test,” used by most states, declares an activity to satisfy the chance element if greater than fifty percent of the result is derived from chance. The predominance test leads to somewhat predictable results and is more objective than the other tests (Okerberg, 2014). In applying this test, fantasy players assert that the outcomes of fantasy games are through hours of strategizing rather than mere luck. The “material element test” looks to whether or not chance has a material effect on the outcome. This test may or may not be the same as the predominance test, depending on whether one believes that material means more than fifty percent. The material element test is subjective because the meaning of "material" is not uniformly defined and applied. (Okerberg, 2014).

The “gambling instinct test” satisfies the chance element if it “appeals to the player’s gambling instinct.” It is unclear exactly how this test can be applied in practice. “The gambling instinct test is problematic given its subjective nature” (Okerberg, 28, 2014). Finally, under the “any chance test” an activity satisfies the chance element “if a particular game contains any chance that influences the outcome of the game.” Under this test all forms of betting on any aspect of a sporting event would be considered gambling, as chance is an inevitable factor in all sporting activities. In the words of University of Texas legendary football coach Darrell Royal, “Breaks balance out. The sun don't shine on the same ol' dog's rear end every day.”

Providers of fantasy sports have argued that their leagues are skill based in order to pass the chance test that exists in many of the states. Since most states use the predominance test, if providers can prove that fantasy sports involve a greater percentage of skill than chance they can successfully refute the argument that fantasy sports constitute gambling. In order to create the perception that fantasy sports involve more skill than luck, providers explicitly advertise them as games of skill. FanDuel’s *Terms of Use*, adamantly declare that “FanDuel is a game of skill,” stating “winners are determined by the individuals who use their skill and knowledge of relevant professional sports...” Advertising as games of skill can be further seen through ESPN, Yahoo’s, and CBS’s tools that are available to participants. Each offers analysis software and expert advice in order to help fantasy players create the best strategies.

To further enhance the perception that fantasy sports are a game of skill, one can look to the nature of the games. Three skill elements are found in a fantasy league: drafting, playing, and trading players (Cabot & Csoka, 2007). Fantasy players must strategize on which players to draft based on past performance and future expectations; to do this, they can use the analysis packages and expert advice offered by their fantasy providers. Refuting the skill argument to some extent is the fact that in traditional fantasy leagues a player can only be chosen once, and participants need to pick players based on the other participant’s choices. Thus, in the traditional leagues, the participant that gets first draft choice has a leg up on the other participants by being able to choose first, creating an element of chance in the draft process.

Moreover, if a league employs the “auto-draft” option, the draft selection will be entirely based on chance and under the predominance test could be considered gambling. On the other hand, in daily leagues, participants need to maximize the output of their players that is restricted by a salary cap; in other words, they need to strategize and draft the players that will optimize the amount of salary they have available to spend. But since daily leagues span a short time-frame, there is more that is left open to chance in the short-term; a player can have an off day or the weather conditions can affect a game. Daily leagues also do not have other strategies characteristic of the traditional leagues. Choosing which players to play every week can be seen as a skill in traditional games that is not available in daily leagues, where only one line-up is chosen for a league. Also, in traditional leagues where players must use their skills to negotiate in trading players with other teams, daily leagues have no interactions between fantasy teams. Therefore, while in daily leagues the research is done before the league and ceases after the commencement of the league, traditional league participants must continually research their players throughout the length of the season.

While these attributes provide justification that fantasy sports are a game of skill, there are still elements of chance in any league just as there are elements of chance in any sport. For example, the risk of injury, adverse weather conditions, suspensions, and other contingencies are the result of chance to a degree. Fantasy providers need to defend their positions that fantasy sports are predominately skill in order to show that the chance element is absent, and hence the activity is not gambling as defined in the majority of states. Some observers contend that luck is a significant factor for success in daily games; however, long-term statistics arguably validate the fact that more skilled players who devote more time to research and other planning consistently outperform other players, thus showing their skill (Ehrman. 2015).

Taking the UIGEA and state laws into account, fantasy providers have carefully placed restrictions on who can participate in their prize leagues. CBS Fantasy Sports Prize leagues restrict residents of Arizona, Iowa, Louisiana, Montana and Washington. FanDuel restricts residents of Arizona, Iowa, New York, Louisiana, Montana, Nevada and Washington. DraftKings restricts residents of Arizona, Iowa, Louisiana, Montana, Nevada and Washington from participation for prizes. Yahoo excludes residents of Florida in addition to Arizona, Iowa, Louisiana, Montana, Nevada and Washington. ESPN restricts residents of North Dakota and Tennessee, in addition to Arizona, Iowa, Louisiana, Montana, Nevada and Washington. Residents of the restricted states are allowed to participate in the paid leagues, but are ineligible to win a prize. All of the providers listed require participants to be at least eighteen years old or the age of majority in their state at the time of the entry.

States Restricted by All of the Major Providers

Fantasy sports contests may qualify as gambling under a number of states’ statutory definition of the term (Davidson, 2002). Nevertheless, the providers’ terms of use highlight the fact that some states are stricter than others on fantasy sports. To analyze the state gambling laws that pertain to fantasy sports, it is easiest to consider the states that the providers explicitly prohibit from participating. States in which the major providers do *not* do business because state laws prohibit fantasy sports include Arizona, Iowa, Louisiana, Montana, and Washington.

Arizona employs the predominance test, so gambling is allowed to a certain extent. However, the reason that fantasy providers choose to restrict Arizona residents from participating comes from the restriction that only players can benefit from social gambling activities, not the providers. Arizona law excludes social gambling from the prohibition, providing that no other person may receive "any benefit, directly or indirectly, from the gambling activity, including benefits of proprietorship, management or unequal advantage or odds in a series of gambles" (Ariz. Rev. Stat. Ann. § 13-3301(7) (2015)). Therefore, providers cannot receive a fee for hosting the league. They can only receive payment if they actually participate in the league and win, assuming they don't have favorable rights. Since the main providers take the excess of the entry fees over the prizes given out, they violate this stipulation. Residents of Arizona are still allowed to play in the leagues, but providers would not be able to allow them to win a prize in a league where a portion of the fees is taken from the entry fees.

Under the statutes and court rulings in Iowa, the chance element has been interpreted to be satisfied if there is "any chance." The Iowa Supreme Court previously declared that whether the game is one of skill or chance was immaterial because the statute provided that playing at any game for any sum of money or other property of any value constituted gambling (Parker-Gordon Importing Company v. Benakis, 1931). As a result, fantasy providers would violate the state gambling laws in Iowa since there is some chance involved in fantasy games: weather conditions, injuries, etc. However, there is hope for the future of fantasy sports in Iowa; recently, a bill was sent to the state senate floor to legalize prizes from fantasy sports leagues.

Louisiana defines gambling as "the intentional conduction, or directly assisting in the conducting, as a business, of any game, contest, lottery, or contrivance whereby a person risks the loss of anything of value in order to realize a profit" (La. Rev. Stat. Ann. § 14:90 A (1)(a) (2015)). The Code goes further to expand the definition of gambling to include "the Internet, World Wide Web, or any part thereof by way of any computer, computer system, computer network, computer software, or any server" (La. Rev. Stat. Ann. § 14:90.3 (B) (2015)). Because fantasy sports participants are not operating "as a business," they would not violate the gambling laws in Louisiana. However, the fantasy leagues would violate gambling Louisiana law since they are conducting leagues as a business and the participants are risking a loss in order to realize a profit.

Montana explicitly regulates fantasy sports gambling in its statutes. The Montana Code makes it lawful "to conduct or participate in a fantasy sports league, including a fantasy sports league that is operated under a pari-mutuel system of wagering" regulated under state law and also makes it unlawful to wager on a fantasy sports league by telephone or by the Internet (Mont. Code Ann. § 23-5-802 (2015)). This prohibition makes it almost impossible for providers to allow Montana residents to participate in fantasy leagues unless they somehow find a way to circumvent the Internet and telephone restrictions. The Code also restricts on the portion of entry fees that providers can take for administrative expenses, requiring that the total value of payouts to all league members to equal the amount collected for entrance, administrative, and transactions fees, minus payment for administrative expenses, and limiting the administrative fee collected for conducting a fantasy sports league to not more than 15% of the amount charged as a participant's entrance fee (Montana Code Ann. § 23-5-805 (2015)). These restrictions makes it far less profitable to operate a league in Montana.

The Washington state constitution prohibits all gambling except that expressly permitted by statute (Wash. Const art. II, § 24). The state Gambling Act authorized 100 square sports pool boards as the sole type of sports betting allowed (Wash. Rev. Code Ann. § 9.46.0335 (2015)); as a result, bracket pools, office sports pools, and fantasy sports have never been authorized as gambling activities in Washington State and are illegal. Judging from the restriction of residents from Washington by most providers, it seems they have heeded the advice from the Washington

State Gambling Commission which warns that all gambling on the Internet is illegal, including all types of sports betting.

Additional States Restricted by Some Providers

In addition to the states mentioned previously, ESPN further restricts residents of two states, Tennessee and North Dakota, from participating in its fantasy sports leagues. Tennessee restricts gambling based on the “any-chance” restriction, concluding that “(1) Gambling is contrary to the public policy of this state and means risking anything of value for a profit whose return is to any degree contingent on chance, or any games of chance associated with casinos, including, but not limited to, slot machines, roulette wheels and the like…” (Tenn. Code Ann. § 39-17-501 (2015)). Since fantasy sports have some degree of chance, they would be illegal gambling activities.

North Dakota also employs the “any-chance” restriction. Its statute defines gambling as “risking any money, credit, deposit, or other thing of value for gain, contingent, wholly or partially, upon lot, chance, the operation of gambling apparatus, or the happening or outcome of an event, including an election or sporting event, over which the person taking the risk has no control,” clarifying that it does not include “lawful contests of skill, speed, strength, or endurance in which awards are made only to entrants or to the owners of entries…” (N.D. Cent. Code § 12.1-28-01 (2015)). Although North Dakota allows contests of skill, fantasy sports would not be legal since it is based partially on chance. Online gambling is prohibited under the state's Constitution, regardless of the amount wagered, and gambling may be conducted only by licensed non-profit organizations. ESPN restricts residents of North Dakota, although the other major providers allow them to participate.

Yahoo alone excludes residents of Florida. The Florida Attorney General concluded in 1991 that the operation of a fantasy sports league would violate state law (Advisory Legal Opinion, AGO 91-03.849.14). Even though Florida uses the predominance test, a Florida statute declares that it is “unlawful to bet on result of trial or contest of skill, etc.—whoever states, bets or wagers any money or other thing of value upon the result of any trial or contest of skill….shall be guilty of a misdemeanor” (Fla. Stat. Title 46 § 849.14 (2015)). Therefore, since a fantasy sports league can be considered a contest, arguably it would be illegal to bet or wager anything of value on fantasy sports.

Given the recent explosive growth of fantasy sports, states across the country are weighing additional regulations for daily fantasy sports (Rott, 2015). In November, the New York Attorney General issued cease-and-desist letters to daily fantasy sports wagering sites DraftKings and FanDuel, ordering both companies to immediately stop accepting wagers inside New York following an investigation by his office that found DraftKings and FanDuel were in violation of New York State law against illegal gambling. In response, FanDuel restricted residents of New York. Similarly, in October the Nevada Gaming Control Board banned unlicensed pay-to-play daily fantasy sports leagues from providing their services to Nevada residents, concluding that the activity constitutes illegal gambling under state law. Yahoo, ESPN, DraftKings and FanDuel now restrict Nevada residents from playing for prizes.

FANTASY SPORTS AND COLLEGE STUDENTS

As the recent actions by the attorney General in New York and the Gaming Board in Nevada demonstrate, more states officials are questioning the need for increasing regulatory control (Heitner, 2015). For example, the Massachusetts State Attorney General recently proposed regulations to prohibit people under the age of twenty-one from playing paid fantasy sports games, as well as to ban fantasy competitions based on college sports, prohibit promotions of paid fantasy sports on high school and college campuses and bar professional athletes, agents and others connected to pro sports from taking part in paid fantasy contests related to their sports. Opponents of college fantasy sports argue that it commercially exploits student-athletes (Gerton, 2009). Is participation by people under the age of twenty-one in fantasy sports leagues widespread and problematic?

To better understand the mentality of fantasy sports participants in that age group, college students at the University of Arkansas were surveyed. Although none of the providers restrict residents of Arkansas, the Arkansas statute is extremely broad, providing that “If a person bets any money or any valuable thing on any game of hazard or skill, upon conviction he or she is guilty of a violation and shall be fined in any sum not less than ten dollars nor more than twenty five dollars” (Ark. Code § 5-66-113 (2015)). Long ago the Arkansas Supreme Court stated that “the rising of money, between two or more persons, on a contest or chance of any kind, where one must be the loser and the other the gainer” constitutes gambling (Portis v. State, 362, 1872).

Presumably because gambling is illegal in the state, a game that involves a “chance of any kind” would also be illegal; thus, fantasy sports leagues with entry fees should be illegal. What is interesting under Arkansas law is that the law allows a losing party in a gambling transaction to recover his or her loss, provided such person files suit within 90 days after the paying of the money or property lost (Arkansas Code § 16-118-103). Since traditional leagues last longer than 90 days, the ability of fantasy participants to recover their entry fees is problematic at best. Daily leagues, on the other hand, could be subject to litigation for the recovery of lost fees since the time between when the entry fee is paid and the end of the competition is much shorter.

The Qualtrics™ survey was sent through the Walton College of Business Listserv at the University of Arkansas and reported 313 responses. A breakdown of the students surveyed reveals that the majority of participants were male (57%), while the class ranking was somewhat evenly spread.

#	Answer	Are you:	Response	%
1	Male		175	57%
2	Female		134	43%
	Total		309	100%

#	Answer	What is your current classification in school?	Response	%
1	Freshman		72	23%
2	Sophomore		65	21%
3	Junior		77	25%
4	Senior		96	31%
5	Graduate Student		0	0%
	Total		310	100%

When asked: "How often do you gamble on a sporting event," the majority of the participants responded never (65%). Eighty-two percent of people who never gambled did not participate in a fantasy league this past season. Of those that reported some gambling, 77% participated in a fantasy sports league over last season. Regarding gender, 93% of females did not participate in a fantasy sports league this past season and 88% said they never gamble on a sporting event.

#	Answer	How often do you gamble on a sporting event?	Response	%
1	Never		202	65%
2	Less than Once a Month		58	19%
3	Once a Month		17	5%
4	2-3 Times a Month		13	4%
5	Once a Week		7	2%
6	2-3 Times a Week		7	2%
7	Daily		9	3%
	Total		313	100%

The majority of respondents reported playing fantasy football (94%). Respondents also reported playing fantasy basketball (21%) and baseball (14%). Other fantasy sports respondents reported playing less often were soccer, women's tennis, women's badminton, hockey, and golf.

#	Answer	What fantasy sports did you play?	Response	%
1	Football		115	94%
2	Baseball		14	11%
3	Auto Racing		2	2%
4	Basketball		26	21%
5	Other		15	12%

ESPN was a dominant favorite as a provider with 79% of students saying they had an ESPN league; Yahoo was a distant second. Eleven and five percent of respondents used daily leagues FanDuel and DraftKings, respectively.

	Answer	Through which provider was your league set up?	Response	%
1	ESPN		96	79%
2	NFL.com		19	16%
3	Yahoo		29	24%
4	CBS		7	6%
5	Fanduel		13	11%
6	Draftkings		6	5%
7	Other		8	7%

Of the 122 students that reported playing fantasy sports, 53% said there was an entrance fee for the league. The majority of these students reported an entrance fee of $10-49. Eleven percent of students reported spending over $100 on their entrance fees. When asked if they would consider the entrance fee a gamble, 74% said yes while 26% said no. This result suggests that while participants may consider fantasy sports a game of skill, they also recognize that there is still some chance element of fantasy sports leagues and that it would constitute a gambling activity.

#	Answer	What was the cost of the entrance fee?"	Response	%
1	$0-9		3	5%
2	$10-49		46	71%
3	$50-99		7	11%
4	Over $100		9	14%
	Total		65	100%

#	Answer	Would you consider the entrance fee a gamble (i.e., a bet)?	Response	%
1	Yes		48	74%
2	No		17	26%
	Total		65	100%

In sum, several observations may be made about college students and their fantasy sports behavior. The majority of students surveyed that said they participated in a fantasy league were male. Students that report some gambling are far more likely to participate in a fantasy league as well. Surprisingly, 65% of students said they never gamble on a sporting event and very few said they gamble multiple times a week. On the other hand, 63% of males said they participated in a fantasy sports league this past season and yet 47% said they never gamble on a sporting event. Fifty-three percent of respondents reported paying an entrance fee for a league, with some paying over $100. What is interesting, is that of those students who said that they never gambled on a sporting event, 27% said they paid an entry fee for a fantasy league, implying that they do not think fantasy leagues count as wagering. Thus, many students did not consider their entry fees to be a gambling activity, which is the impression fantasy sports providers want to convey.

CONCLUSION

Fantasy sports have become a widespread way for fans to test their skills and knowledge of sports. Available for almost any sport, fantasy sports have come a long way since its creation in the eighties. Daily fantasy leagues now allow participants to test their skills for big money. The UIGEA gave rise to the legitimacy of paid fantasy leagues. For fantasy paid leagues to remain legal, providers will need to meet three specific requirements of the UIGEA. They must ensure that 1) their fantasy league prizes are determined before the games and not by the fees collected; 2) there is a method of assessing the knowledge and skills of the players which is determined by a scoring system that spans multiple events; and 3) the winning outcome of a league is not based on the score of any one team or a single athlete.

While a fantasy league may pass the requirements of the UIGEA, it still must consider applicable state regulations, as the UIGEA makes it illegal for a fantasy provider to accept any financial instrument from unlawful internet gambling as defined by state law. States vary on what they consider gambling, but three elements are common amongst all states: consideration, reward, and chance. In terms of gambling, consideration can be taken as providing something of value for the chance of greater winnings. Reward can be interpreted as the prize from winning a bet. The third element, chance, is something that happens unpredictably. Chance is the main issue to consider when determining whether or not paid leagues are illegal in a state. Most states use the predominance test, which declares an activity to satisfy the chance requirement if it is predominately based on chance (more than 50%). In these states, it is necessary for providers to provide factual evidence that fantasy sports is a game of skill, not chance. In states that use a different test for chance, or any of the other elements, fantasy providers must review statutes carefully to determine whether or not they could be subject to litigation.

Recently, state officials seem to be taking a harder look at fantasy sports, particularly the daily leagues. As the survey confirms, many participants are convinced that they are playing a legal game of skill and not one of chance; however, in essence state legislatures may be less concerned with the moral corruption of players in the daily leagues, and more interested in the potential revenue generation if fantasy sports leagues are regulated and taxed. Arguably, the profit margin is not sufficiently wide enough to withstand taxation at the level of casinos (Boudway & Brustein, 2015). Some commentators argue for more federal regulations and a licensing scheme for online fantasy sports leagues to protect participants from fraud and assure players of some measure of legitimacy (Lee, 2008-09). The continued viability of fantasy sports, particularly the daily leagues, ultimately may depend on whether or not state officials are willing to prosecute the fantasy sport companies, whether or not the leagues can lobby for favorable regulations and whether or not the leagues can incite their participants to petition their lawmakers to keep the games legal and accessible.

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RESPONDING TO OCCUPATIONAL SAFETY AND HEALTH ADMINISTRATION (OSHA) WHISTLEBLOWER INVESTIGATIONS: POLICY AND PRACTICE ISSUES FOR EMPLOYERS

Gerald Calvasina, Southern Utah University
Richard Calvasina, University of West Florida
Eugene Calvasina, Southern University

ABSTRACT

In fiscal year (FY) 2014, the United States (US) Occupational Safety and Health Administration (OSHA) accepted 3,060 whistleblower cases for investigation. This marked the first time in its history that the agency had surpassed 3,000 cases (Maurer, 2015). The OSHA Whistleblower Protection Program enforces 22 federal statutes protecting employees that report violations of a wide variety of federal laws. From workplace safety to securities laws, the depth and breadth of the program's reach takes in a wide swath of the American economic landscape. The purpose of this paper is to briefly examine the reach of OSHA's Whistleblower Protection Program, to examine where the agency's resources have been focused in recent years, and to identify policy and practice suggestions for employers to facilitate compliance.

INTRODUCTION

The OSHA Whistleblower Protection Program enforces 22 federal statutes protecting employees that report violations of a wide variety of federal laws (Table 1). From workplace safety to securities laws, the depth and breadth of the program's reach takes in a wide swath of the American economic landscape.

Table 1
FEDERAL STATUTES CONTAINING WHISTLEBLOWER PROTECTION FOR EMPLOYEES

Statute	Title
29 U.S.C. § 218C	Affordable Care Act (ACA), Section 1558
15 U.S.C. §2651	Asbestos Hazard Emergency Response Act (AHERA)
42 U.S.C. §7622	Clean Air Act (CAA)
42 U.S.C. §9610	Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)
12 U.S.C.A. §5567	Consumer Financial Protection Act of 2010 (CFPA), Section 1057 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
15 U.S.C. §2087	Consumer Product Safety Improvement Act (CPSIA)
42 U.S.C. §5851	Energy Reorganization Act (ERA)
21 U.S.C. 399d	FDA Food Safety Modernization Act (FSMA), Section 402
49 U.S.C. §20109	Federal Railroad Safety Act (FRSA)
33 U.S.C. §1367	Federal Water Pollution Control Act (FWPCA)
46 U.S.C. §80507	International Safe Container Act (ISCA)
49 U.S.C. §30171	Moving Ahead for Progress in the 21st Century Act (MAP-21)
6 U.S.C. §1142	National Transit Systems Security Act (NTSSA)
29 U.S.C. §660	Occupational Safety and Health Act (OSH Act), Section 11(c)
49 U.S.C. §60129	Pipeline Safety Improvement Act (PSIA)
42 U.S.C. §300j-9(i)	Safe Drinking Water Act (SDWA)
18 U.S.C.A. §1514A	Sarbanes-Oxley Act (SOX)
46 U.S.C. §2114	Seaman's Protection Act (SPA), as amended by Section 611 of the Coast Guard Authorization Act of 2010, P.L.
42 U.S.C. §6971	Solid Waste Disposal Act (SWDA)
49 U.S.C. §31105	Surface Transportation Assistance Act (STAA)
15 U.S.C. §2622	Toxic Substances Control Act (TSCA)
49 U.S.C. §42121	Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR21)
Source: United States Department of Labor, (DOL, 2015).	

In fiscal year (FY) 2014, the United States (US) Occupational Safety and Health Administration (OSHA) accepted 3,060 cases for investigation (Table 2). This marked the first time in its history that the agency had surpassed 3,000 cases (Maurer, 2015). The purpose of this paper is to briefly examine the reach of OSHA's Whistleblower Protection Program, to examine where the agency's resources have been focused in recent years, and to identify policy and practice suggestions for employers to facilitate compliance.

Table 2
WHISTLEBLOWER CASES RECEIVED FY 2005 - 2014

Statute	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
ACA	0	0	0	0	0	4	14	14	18	26
AHERA	2	0	1	1	6	6	3	4	3	3
AIR21	65	52	50	85	92	75	66	57	91	111
CFPA	0	0	0	0	0	0	6	14	28	47
CPSIA	0	0	0	2	4	6	2	5	4	6
EPA	56	60	61	51	46	46	42	54	67	52
ERA	52	53	23	41	48	50	50	50	64	39
FRSA	0	0	1	45	145	201	340	384	355	351
FSMA	0	0	0	0	0	0	17	22	54	51
ISCA	0	0	0	0	0	1	0	0	0	0
MAP21	0	0	0	0	0	0	0	0	1	10
NTSSA	0	0	0	18	15	14	17	14	17	14
OSHA	1194	1195	1301	1381	1267	1402	1667	1745	1710	1729
PSIA	3	7	1	3	3	2	6	2	7	6
SOX	291	234	231	235	228	201	148	169	177	145
SPA	0	0	0	0	0	0	5	9	5	7
STAA	271	241	297	357	306	306	314	346	368	463
Total	1934	1842	1966	2219	2160	2314	2698	2889	2969	3060

Source: United States Department of Labor, (DOL, 2015).

OSHA'S WHISTLEBLOWER PROTECTION PROGRAM

The passage of the Occupational Safety and Health (OSH) Act in 1970 signaled the beginning of a new era in protection of worker rights to a safe and healthy work environment. Section 11(c) of the Act specifically prohibits employers from discriminating against employees who exercise a wide variety of rights under the OSH Act including the filing of complaints, participating in inspections, reporting an injury, raising a safety or health complaint with their employer, and reporting a violation of the statutes herein (DOL, 2015, A). Workers are also protected from retaliation or discrimination in the exercise of their rights under the act. Over time, the US Congress has expanded OSHA's whistleblower authority to protect workers from retaliation and discrimination under the twenty-two federal statutes listed in Table 1. Worker complaints must be reported to OSHA within set time frames proscribed by each statute following the alleged discriminatory action (Table 3).

Table 3
DAYS TO FILE COMPLAINTS UNDER WHISTLEBLOWER STATUTES

Occupational Environmental and Nuclear Safety Laws	Days to file
Section 11(c) of the Occupational Safety & Health Act (OSHA). [29 U.S.C. §660(c)]	30
Asbestos Hazard Emergency Response Act (AHERA). [15 U.S.C. §2651]	90
Clean Air Act (CAA). [42 U.S.C. §7622]	30
Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). [42 U.S.C. §9610]	30
Energy Reorganization Act (ERA). [42 U.S.C. §5851]	180
Federal Water Pollution Control Act (FWPCA). [33 U.S.C. §1367]	30
Safe Drinking Water Act (SDWA.) [42 U. S. C. §300j-9(i)]	30
Solid Waste Disposal Act (SWDA). [42 U.S.C. §6971]	30
Toxic Substances Control Act (TSCA). [15 U.S.C. §2622]	30
Transportation Industry Laws	
Federal Railroad Safety Act (FRSA). [49 U.S.C §20109]	180
International Safe Container Act (ISCA) [46 U.S.C. §80507]	60
Moving Ahead for Progress in the 21st Century Act (MAP-21). [49 U.S.C. §30171]	180
National Transit Systems Security Act (NTSSA). [6 U.S.C. §1142]	180
Pipeline Safety Improvement Act (PSIA). [49 U.S.C. §60129]	180
Seaman's Protection Act, 46 U.S.C. §2114 (SPA), as amended by §611 of the Coast Guard Authorization Act of 2010, Public Law 111-281.	180
Surface Transportation Assistance Act (STAA). [49 U.S.C §31105]	180
Wendell H. Ford Aviation Investment and Reform Act for the 21st Century (AIR21). [49 U.S.C. §42121]	90
Consumer and Investor Protection Laws	
Affordable Care Act. 29 U.S.C. §218C (ACA)	180
Consumer Financial Protection Act (CFPA). [12 U.S.C. §5567].	180
Sarbanes-Oxley Act (SOX). [18 U.S.C. §1514A]	180
Consumer Product Safety Improvement Act (CPSIA). [15 U.S.C. §2087]	180
FDA Food Safety Modernization Act (FSMA) [21 U.S.C. 399d].	180
Source: (DOL, 2015, B).	

Threats, acts of intimidation, and taking adverse actions against employees are examples of the common retaliatory actions taken by employers to discourage whistleblowers (Yeargain and Kessler, 2010). Unfavorable employment actions identified by the U.S. Department of Labor (DOL) that can lead to complaints against employers include those listed in Figure 1.

Figure 1
UNFAVORABLE EMPLOYMENT ACTIONS AGAINST EMPLOYEES

Firing or laying off
Blacklisting
Demoting
Denying overtime or promotion
Disciplining Denying
benefits Failing to hire
or rehire Intimidation
Making threats
Reassignment affecting prospects for promotion
Reducing pay or hours

Source: United States Department of Labor, (DOL), (2015, C)

Procedures for filing complaints and investigation of complaints can vary by statute. For example, an allegation of discrimination or retaliation against an employee that has attempted to exercise a right as an employee under the OSH Act must be filed within 30 days of the alleged discriminatory employment action. In states where an OSHA approved state plan is available, the employee may file a complaint with both the State and Federal OSHA offices. Individuals may file online, using OSHA's Online Whistleblower Complaint Form, via mail to a local OSHA Regional or Area Office, or telephone United States Department of Labor, (DOL), 2015), D). There are 22 states or territories that have OSHA-approved State Plans that cover both private and public sector workers (Figure 2).

Figure 2
STATE/TERRITORIES WITH OSHA-APPROVED STATE PLANS

Alaska	New Mexico
Arizona	North Carolina
California	Oregon Hawaii
	Puerto Rico
Indiana	South Carolina
Iowa	Tennessee
Kentucky	Utah
Maryland	Vermont
Michigan	Virginia
Minnesota	Washington
Nevada	Wyoming

Source: United States Department of Labor, (DOL), (2015, E)

Filing a complaint under any other whistleblower statute enforced by OSHA must be filed within the appropriate time limits specified in the statute and must be filed directly with Federal OSHA (United States Department of Labor, (DOL), 2015), D).

REMEDIES

The remedies available to individuals under OSHA's whistleblower protection program "vary according to statute and are subject to legal interpretations and decisions" (Fairfax, 2007). Allowable remedies under all statutes include reinstatement orders, awards of back pay, and compensatory damages. Back pay awards are offset by interim earnings. In some cases, "front pay" may be allowed. Front pay "encompasses future wage losses, calculated from the end-date of back-wages, and projected to an agreed-upon future date in cases where reinstatement is not feasible" (Fairfax, 2007). Available remedies available also include those designed to address the impact of violations on the entire workforce. These remedies include requiring management to post appropriate notices in the workplace as to the resolution of complaints, required management training, and informational speeches to workers and their representatives. These remedies are designed to "prevent a chilling effect or to ensure that a similar violation does not recur" (Fairfax, 2007). Punitive damages may also be available under certain statutes including OSHA (1970), (DWPP, 2013). Punitive damages may be provided "when a management official involved in the adverse action knew about the relevant whistleblower statute before the adverse action or when the respondent's conduct is egregious" (Fairfax, 2007).

FOCUS OF OSHA ACTIVITY

From Table 2 it is quite obvious that the OSH Act is the focal point of complaints received by OSHA in recent years. The number of complaints received alleging violation of OSH since FY 2005 has steadily increased from 1194 in 05 to 1729 in FY 2014. A distant second are the cases involving the Surface Transportation Assistance Act (STAA) of 1978 with 463 cases received in FY 2014. The Federal Railroad Safety Act (FRSA) of 1982 is a distant third with 351 cases filed in FY2014 and those numbers are down from the high of 384 cases received in FY 2012. Complaints alleging violation of Sarbanes Oxley (SOX) were a distant fourth and involved only half as many cases as those received in FY 2005.

While the number of complaints received has reached an all-time high, cases dismissed or withdrawn by complainants also remained high. In 2014, OSHA completed determinations on 3,271 complaints, 51 percent (1652) were dismissed by the agency and another 22 percent were withdrawn by the complainant (Maurer, 2015). Table 4 contains FY 2005 – FY 2014 breakdown of complaint determinations. Over the last ten years, the number of complaints dismissed by OSHA has consistently declined from a high of 67 percent (1270) in 2005 to the 51 percent level of 2014. The number of complaints settled over the ten year period has consistently increased from a low of 16 percent in 2005 to 28 percent in 2011. The percentage of cases settled dipped in 2012 to 21 percent but rebounded to 26 percent in 2013 and then declined to 24 percent in 2014. Meritorious determinations averaged right at 2 percent over the ten year period. In merit determination cases, a worker and employer were unable to agree on a settlement and OSHA decides that a judge should hear the complaint (Maurer, 2015).

Table 4
COMPLAINT DETERMINATIONS FY 2005 - 2014

Fiscal Year	Merit	Settled	Settled Other	Dismissed	Withdrawn	Total
2005	41	269	87	1270	235	1902
2006	23	284	117	1275	272	1971
2007	18	261	112	1217	253	1861
2008	21	328	95	1280	296	2020
2009	57	277	116	1221	272	1943
2010	45	312	138	1182	278	1955
2011	48	400	157	1110	278	2016
2012	48	406	187	1662	518	2869
2013	74	527	333	1596	669	3272
2014	64	441	305	1652	710	3271
Total	439	3505	1647	13465	3781	23080

Source: United States Department of Labor, (DOL, 2015).

RECENT OSHA CASES AND ISSUES

Among recent high profile cases involving OSHA whistleblower allegations include a recent determination by OSHA involving the presence of a “culture of retaliation” at Union Pacific Railroad. In the Union Pacific Railroad case involving the disciplining of a locomotive engineer for reporting a workplace injury, OSHA ordered the employer to pay $350,000 in punitive and compensatory damages and reasonable attorney fees. The company was also ordered to remove disciplinary information from the employee’s personnel file and to provide information about whistleblower rights to all its employees. In announcing the determination, OSHA noted that the company had more than 200 whistleblower nationwide complaints since 2001 and that the repeated complaints were indicative of a culture that does not value the safety of its workers (OSHA Regional News Release, 2015).

In addition to investigating a record number of complaints associated with whistleblowing, OSHA has also been active in initiating changes in its processes and policies designed to provide even more protection for whistleblowers.

In 2013, OSHA launched its Temporary Worker Initiative (DOL News Release, 2013). This initiative was designed to enhance safety and health requirements for temporary workers employed under a joint employment relationship involving a temporary staffing agency and a host employer (Maurer, 2015, A). In Temporary Worker Initiative (TWI) Bulletin No. 3 released in April of 2015, OSHA noted that “temporary workers have the same rights and protections against retaliation as all other workers” and reiterated that protection with respect to whistleblowers extends to all 22 statutes that OSHA is responsible for enforcement of whistleblower provisions (TWI Bulletin No. 3, 2015).

In April of 2014, David Michaels, Assistant Secretary for Occupational Safety and Health for the U.S. Department of Labor, testified before Congress "that a longer statute of limitations was needed for OSH Act whistle-blower claims" (Smith, 2014). In his testimony, Michaels endorsed the idea that the statute of limitations should be amended to match newer whistle- blower statutes that typically have a 180 day statute of limitations (Smith, 2014). On May 21, 2014, Associate General Counsel of the National Labor Relations Board (NLRB) Anne Purcell issued Memorandum OM 14-60 informing all Regional Directors, Officers-in-Charge, and Resident Officers of the NLRB that the NLRB had entered into a program with OSHA regarding the OSHA case intake process regarding whistleblower claims (Purcell, 2014). Under the program, OSHA complaints that would normally be dismissed because the complainant had failed to file a timely complaint will now be referred to the NLRB to assess the possibility of the complainant filing an unfair labor practice charge against the employer. OSHA estimates that annually, 300 to 600 cases each year are dismissed because of the 30-day statute of limitation period and that the 180 day time frame for unfair labor practice charge filing will provide complainants with additional time to have their complaints investigated (Purcell, 2014). OSHA agents will be trained to provide talking points regarding NLRB procedures and will provide complainants with contact information. The NLRB has established a separate toll free number for use by complainants specifically for OSHA referral (Purcell, 2014). In August of 2014, the NLRB Associate General Council issued another memorandum to regional offices instructing them on referral procedures with respect to unfair labor practice charge investigations that uncover possible violations of the OSH Act or fair wage, recordkeeping, and child labor provisions of the Fair Labor Standards Act (Purcell, 2014, A).

POLICY AND PRACTICE RECOMMENDATIONS

With all the legal protection afforded employees and the adverse publicity heaped on employers that become the focal point of whistleblower allegations, why the increase in complaints? Some would say it's the money involved and others more altruistic employees.

It is ironic, as noted by Virginia Tech sociology professor Joyce Rothchild, that "employees aren't labeled as whistle-blowers until the company decides to retaliate against them" (Meinert, p. 62, 2014). An employee who reports a dangerous condition or misconduct by another employee to a manager who then corrects the situation or stops the misconduct might be viewed as an employee who "has an observation to share" or even a conscientious employee(Meinert, p. 62, 2014). The rationale for retaliation is clear – attempting to discourage employees from raising allegations of an organization's misdeeds' and to "make an example of the whistleblowers" to discourage "those who wish to report an act that is a violation of a law, a regulation, or a rule" (Yeargain and Kessler, 2010).

Lawsuits associated with retaliation against whistleblowers has also been described as "the high cost of getting even", when "angry managers who are accused of wrongdoing" take adverse employment actions against those employees (Meinert, p. 64, 2014). Meinert also notes that "retaliation charges are the most common claims filed with the U.S Equal Employment Opportunity Commission", and that they are often easier to prove than discrimination claims (Meinert, p. 63-64, 2014). Figure 3 contains the types of retaliation experienced by employees who reported misconduct in a study conducted by the National Business Ethics Center in 2013.

Figure 3
TYPES OF RETALIATION EXPERIENCED BY EMPLOYEES WHO REPORT MISCONDUCT IN 2013

Supervisor intentionally ignored or began treating differently 69%
Other employees intentionally ignored or began treating differently 59%
Supervisor or management excluded from decisions and work activity 54%
Verbally abused by supervisor or someone else in management 49%
Not given promotions or raises 47%
Verbally abused by other workers 43%
Almost lost job 38%
Hours or pay were cut 29%
Relocated or reassigned 28%
Demoted 21%
Harassed at home 18%
Experienced physical harm to person or property 16%
Experienced online harassment 15%

Source: 2013 National Business Ethics Survey, Ethics Resource Center

There are a number of often cited policy and practice recommendations to lower the risk of whistleblower complaints. At the top of the list, is the development and maintenance of an organizational culture "where employees are comfortable reporting wrongdoing internally and by protecting them after they do so" (Meinert, p. 64, 2014). Developing and maintaining this type of culture is no easy task. Building and maintaining employee trust and confidence in how the organization and its mangers will respond to these types of allegations is fragile. Providing employees with the internal mechanisms to create the "speak-up culture" required to encourage employees to come forward with allegations of organizational wrong-doing requires much more than the proverbial open door (Smith, 2015). It requires, according to many in the legal community, the "development of a fair and consistent process for employees to make reports and for how reports will be investigated" (Meinert, p. 64, 2014). Figure 4 contains common recommendations from the legal profession.

Figure 4
RECOMMENDATIONS FROM THE LEGAL PROFESSION

Create an integrated system for taking reports of misconduct, and make sure employees know what methods to use.
Develop a plan for handling reports when they come in. Who will investigate? Who will notify the employee about the outcome?
Ensure that company policy prohibits retaliation against employees who report wrongdoing, and enforce it.
Train managers to take all complaints seriously and to avoid retaliation.
Avoid language in severance agreements that could appear to muzzle employees from assisting with future investigations.

Source: (Meinert, p. 62, 2014)

SUMMARY AND CONCLUSIONS

Another consistent theme in the literature is the importance of quality first line supervision. In the 2013 National Business Ethics Survey cited by Meinert, 92 percent of employees who reported misconduct initiallydid so "to someone inside their organization, usually their direct supervisor" – "just 9 percent reported problems to a government agency" (Meinert, p. 62, 2014). Training and reinforcement of that training for first line supervisors is critical. Just like the tenuous nature of most open door policies, any system that provides negative reinforcement at the most likely first contact for an employee, is doomed to failure.

Not providing whistle-blower training may also not be an option for covered employers given recent updates to OSHA's Whistle-Blower Investigations Manual (Maurer, 2015, B). The updates to the OSHA manual include revisions to determining when punitive damages are appropriate, clarification of what employers must do to raise a good-faith defense in defending against punitive damages, when front pay may be an appropriate remedy, calculation of back pay and the availability of emotional distress damages (Maurer, 2015, B). Maurer goes on to note that "for the first time, employers could be required to provide whistle-blower training to current employees and/or managers as part of settling a whistle-blower claim" (Maurer, 2015, B).

Whether it is one of the 22 statutes enforced by OSHA or the other multitude of federal and state laws that provide protection to employees regarding retaliation, organizations must impress upon all members of management to treat employee allegations of wrongdoing seriously. Dori Meinert's HRMagazine June 2014 article should be required reading for all managers – from the very top to the very bottom of any organization's hierarchy.

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HEALTH CARE IN CANADA TO OVERCOME INCOME INEQUALITY

Egbert McGraw, University in Moncton
Yves Robichaud, Laurentian University

ABSTRACT

Income inequality has increased over the last years between the rich and the poor, but in many countries, government transfers and social programs play an important role in reducing income inequality. In this paper, we will study health care financing in Canada as a social transfer to fight income inequality. Our progressive tax rate system has the effect of the rich paying for the poor. Canadian families with the lowest income will pay an average total tax bill of $2,148 (16%) and an average health care insurance of $523. On the other side of the spectrum, the 10 percent of Canadian families with an average income of $278,012 will pay an average total tax bill of $152,869 (55%) and a health care insurance of $37,239. In addition, the Government of Canada provides significant support to provincial and territorial governments with transfers that enable less prosperous provincial governments to provide their residents with public services to support social programs that some Canadians could not afford, thus reducing income inequality.

INTRODUCTION

The Conference Board of Canada (2014) is concerned that income inequality in Canada has increased over the past 20 years. Since 1990, the richest group of Canadians has increased its share of total national income, while the poorest and middle-income groups have lost ground.

The same phenomenon is also happening in the United States. For example, the Economist reported that the democratization of living standards has masked a dramatic concentration of wealth over the past 30 years, on a scale that matches, or even exceeds, the first Golden Age. Including capital gains, the share of national income going to the richest 1% of Americans has doubled since 1980, from 10% to 20%, roughly where it was a century ago. Even more striking, the share going to the top 0.01%, some 16,000 families with an average income of $24M, has quadrupled from just over 1% to 5%. This is a bigger slice of the national pie than the top 0.01% received 100 years ago (The Economist, 2012).

This paper will attempt to investigate the concept of income inequality in Canada and, as such, will address the following two objectives: firstly, to show that income inequality has increased over the last years between the rich and the poor, and secondly, what measures are used in Canada in order to diminish income inequality.

In the first part of the paper we will present data on the taxpayers' share of income and taxes in Canada. The second part will cover income and wealth inequality on OECD countries before and after social transfers. In the following section, we will use health care in Canada as an example of income distribution. In the last two sections, we will try to identify who pays for health care by presenting the tax bill for each Canadian based on his/her income and the federal transfers to the provinces to fight income inequality and support social programs such as health care. We will finish with a conclusion.

TAXPAYERS' SHARE OF INCOME AND TAXES IN CANADA

An analysis of the most recent Statistics Canada survey on market, total and after-tax income by economic family type shows that in general, Canada's richest 20% of families takes over 50% of all income. To that effect, we are presenting three tables from Statistics Canada that covers the period from 2007 to 2011 (see Tables 1-A, B, C). These tables ranked the taxpayers by the value of their income on a specified income concept (Market, Total, or Aggregate tax paid). Then, the ranked population is divided into five groups of equal numbers of units, called quintiles. The concept of income covers income received while residents of Canada, or as relevant for income tax purpose in Canada. Market income is the sum of earnings from employment and net self- employed, net investment income, private retirement income and the items on other income. Total income refers to income from all sources including government transfers and before taxes. Table 1-A presents the distribution of Market income in five quintiles for the years 2007 to 2011. For 2011, the highest quintile earned 52.3% of the total Market income earned in Canada, and the lowest quintile earned approximately 1% of the total Market income, showing that income is not evenly distributed. For example, in 2011, the two highest quintiles earned 77.2% (24.9% + 52.3%) of the Market income, and the three lowest quintiles, or 60% of the population, earned 22.8% (1.0% + 7.2% + 14.6%) of the total Market income. We can also observe an increase in inequalities in income distribution from 2007 to 2011. The highest quintile saw an increase in the Market income compared to the two lowest quintiles in which a decrease could be observed.

Table 1-B shows the Total income distribution, which includes government transfers to the lower incomes, and it is slightly more distributed. For example, in 2011, the highest quintile earned 47.2% of the Total income, compare to 52.3% for the Market income (Table1-A), and the lowest quintile earned 4.1% compared to 1% for the Market income. Government transfers and credits for the families and the unprivileged can explain a better distribution of the Total income as compared to the distribution of Market income.

These tables have shown that income distribution is not distributed evenly between all quintiles, with the highest quintile earning a higher percentage of the Total or Market income. However, the tax system in Canada tries to share wealth between taxpayers by imposing a graduated tax rate system, with higher tax rates for a higher level of income. We will see later in this paper that the tax system tries to overcome income inequality by way of government transfers and social programs.

Table 1-C presents the share of the Aggregate income tax paid by each quintile. The highest quintile share of the tax paid was 61.6%, compared to approximately 0.9% for the lowest quintile. The two highest quintiles, 40 percent of taxpayers, paid 83.7% (22.1 + 61.6) of the tax, and the remaining 60% of taxpayers paid 16.3%, showing that the highest earners paid a large share of the income tax. As we can recall from table 1-A, the highest quintile earned 52.3% of the total Market income but paid 61.6% of the Aggregate income tax.

Table 1

A- SHARE OF MARKET INCOME (PERCENT) FOR ALL FAMILY UNITS IN CANADA 2007 TO 2011 (CANSIM 202-0701)

	2007	2008	2009	2010	2011
Lowest quintile	1.3	1.2	1.1	1,0	1.0
Second quintile	7.5	7.4	7.2	7,1	7,2
Third quintile	14.9	14.9	14,7	14,6	14.6
Fourth quintile	24.5	24.6	24.7	24.7	24.9
Highest quintile	51.8	51.9	52.4	52.6	52.3

B- SHARE OF TOTAL INCOME (PERCENT) FOR ALL FAMILY UNITS IN CANADA 2007 TO 2011 (CANSIM 202-0701)

	2007	2008	2009	2010	2011
Lowest quintile	4.2	4.2	4.2	4.2	4.1
Second quintile	9.7	9.5	9.6	9.6	9.6
Third quintile	15.5	15.5	15.4	15.3	15.3
Fourth quintile	23.6	23.6	23.7	23.6	23.8
Highest quintile	47.1	47.2	47.1	47.3	47.2

C- SHARE OF AGGREGATE INCOME TAX PAID (PERCENT) FOR ALL FAMILY UNITS IN CANADA 2007 TO 2011 (CANSIM 202-0501)

	2007	2008	2009	2010	2011
Lowest quintile	1.6	0.9	0.9	1.6	0.9
Second quintile	4.8	4.6	4.3	4.2	4.6
Third quintile	11.4	11.4	11.0	10.8	10.8
Fourth quintile	21.6	21.7	21.7	21.6	22.1
Highest quintile	60.6	61.3	62.1	61.9	61.6

These tables support the views that Canada's richest families account for a large percentage of all income. Studies on wealth show similar results. As you move up the income ladder, the wealth gap is even greater. The Canadian Centre for Policy Alternatives (CCPA) reported that over a 13 year period, there has been a pronounced increase in wealth in Canada, but that wealth has flowed into the hands of a concentrated few. Almost 70% of all Canadian wealth belongs to Canada's wealthiest 20%. Moreover, for every new dollar of real wealth generated in Canada since 1999, 66 cents of that dollar has gone to the wealthiest 20% of families. For every new dollar in real wealth generated in Canada since 1999, the upper middle class reaped 23 cents, while the bottom 60% of families had to settle for the last dime.

As reported in the CCPA document, the level of wealth inequality in Canada has reached such extremes that in 2012, according to figures derived for Canadian Business magazine, the 86 wealthiest Canadians (and families) held the same amount of wealth as the poorest 11.4 million Canadians combines (Canadian Business magazine, 2012; Canadian Centre for Policy Alternatives, 2014).

However, income is only a partial measure of social welfare. It refers only to private resources, and does not take into account the benefits derived from public expenditures, such as those on education and health care (Atkinson, 2003). In the next section of the paper we will look at the measures put in place by the Canadian government to reduce income inequality.

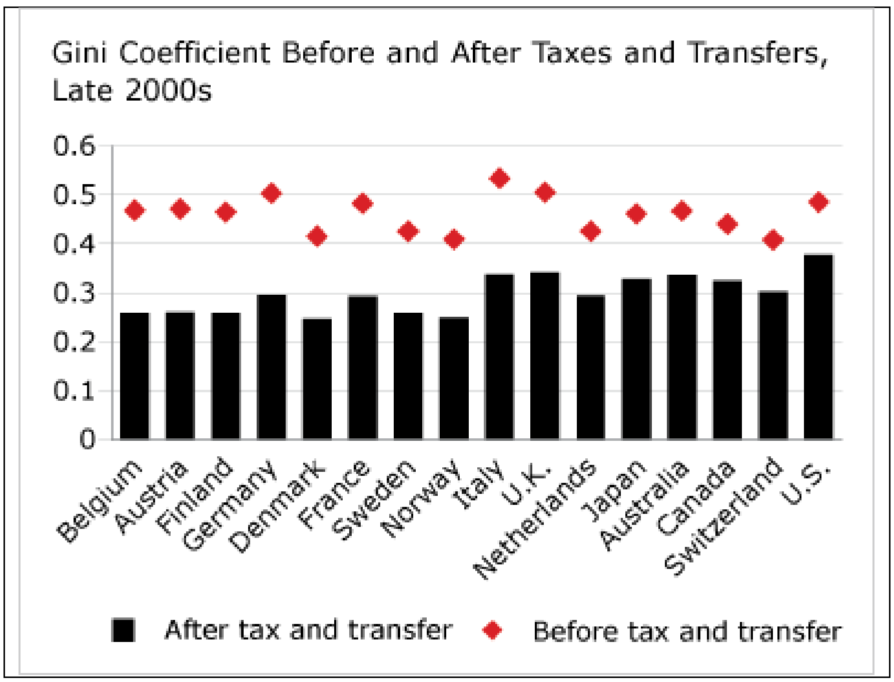
MEASURES TO DIMINISH INCOME INEQUALITY

A study by the Conference Board of Canada (2014) shows that personal income taxes and government transfers (such as social assistance, unemployment insurance, old age security, and child benefits) play an important role in reducing income inequality. Reduction of income inequality can be seen by comparing two Gini coefficients: one calculated using income before taxes and transfers, and the second using income after taxes and transfers. Figure 1 shows the two coefficients for 16 countries, including Canada and the U.S.

The red squares show the levels of the Gini coefficients before taxes and transfers for each country. For example, the most unequal country using the Gini coefficient is Italy, with a Gini coefficient of 0.53, followed by the U.K. and Germany. The U.S. has the fourth-highest income inequality, while Canada has the eleventh-highest.

The Chart in figure 1 shows the Gini coefficient after income is adjusted by taxes and transfers. The Chart ranks the countries from left to right based on the size of the decline in inequality due to the tax and transfer system. For example, Belgium is the country with the highest decrease in the Gini coefficient (45% drop), and the U.S. with the lowest drop in inequality (22% drop, from 0.486 to 0.370). Canada's tax and transfer system does reduce inequality by 27%, from 0.441 to 0.324.

Figure 1



Source: The Conference Board of Canada (2014)

The previous figure is a good indication of the reduction of income inequality by government transfers and spending on social programs. Because of its importance, in term of cost and of priority by Canadians, we will use health care expenses in Canada as an example of income redistribution to overcome income inequality.

HEALTH CARE IN CANADA

The World Trade Organisation Constitution enshrines the highest attainable standard of health as a fundamental right of every human being and includes access to timely, acceptable, and affordable health care of appropriate quality. The right to health means that States must generate conditions in which everyone can be as healthy as possible (World Trade Organization, 2013). First, we will examine statistics on health expenditures at the international level and at the end we will shift to Canada's position on income distribution and health care.

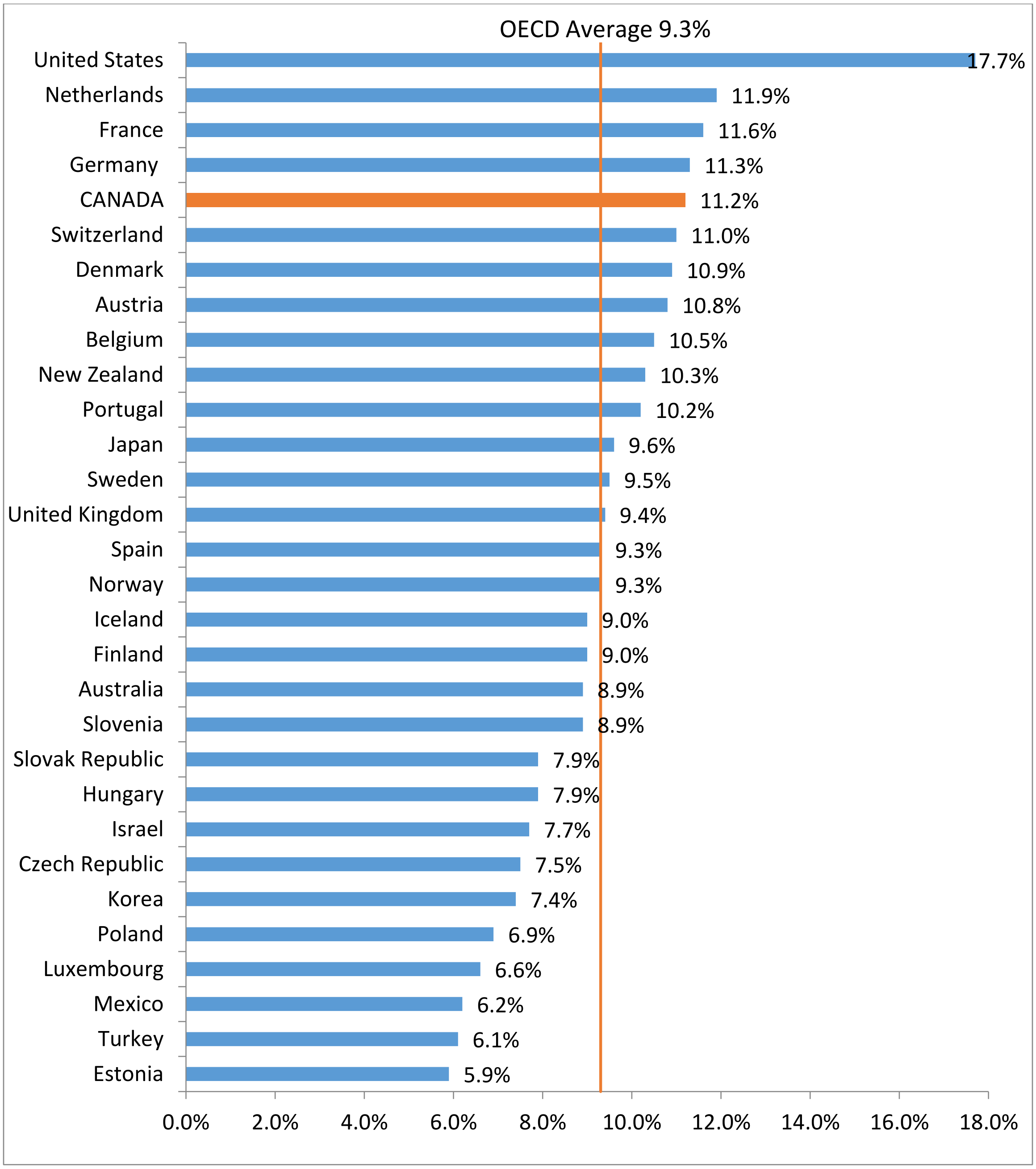
For the last 13 years, the OECD has been updating the information on health expenditures according to concepts presented in the OECD manual *A System of Health Accounts* (SHA). (OECD 2013) Total expenditure on health is defined by the OECD as the sum of expenditure on activities that, through application of medical, paramedical and nursing knowledge and technology, has goals of:

Promoting health and preventing disease;
Curing illness and reducing premature mortality;
Caring for persons affected by chronic illness who require nursing care;
Caring for persons with health-related impairments and disabilities who require nursing care;
Assisting patients to die with dignity;
Providing and administering public health; and
Providing and administering health programs, health insurance and other funding arrangements.

In this section we will present the health expenditures information for the 30 countries that most closely follow the health care boundary proposed in the Organisation for Economic Co-Operation and Development (OECD) manual.

Figure 2 presents the total health expenditure as a percentage of GDP for 30 selected countries in 2011. In 2011, the United States had the highest ratio of total health expenditures to GDP, at 17.7% while Canada was at 11.2% in 5th position.

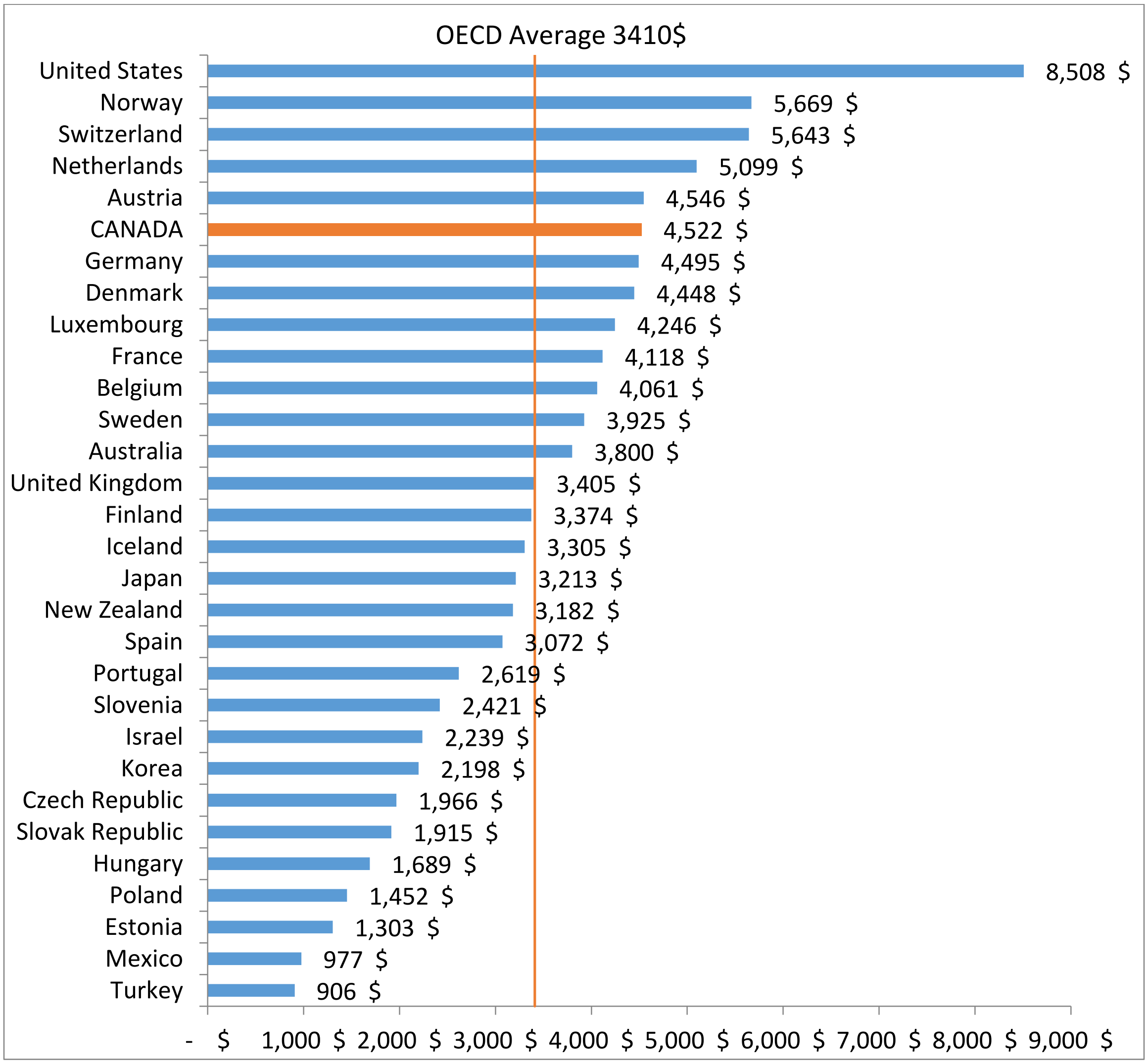
Figure 2
TOTAL HEALTH CARE EXPENDITURE AS A PERCENTAGE OF GPD, 30 OECD COUNTRIES



Source: National Health Expenditure Trends, 1975 to 2013/OECD Health Data 2013.

Figure 3 shows the total health expenditure per capita, in U.S. dollars, for 30 selected countries in 2011. The United States had the highest health expenditure per individual, at US$8,508, and Canada, with a spending of US$4,522 per person was among the six countries with the highest per capita spending on health.

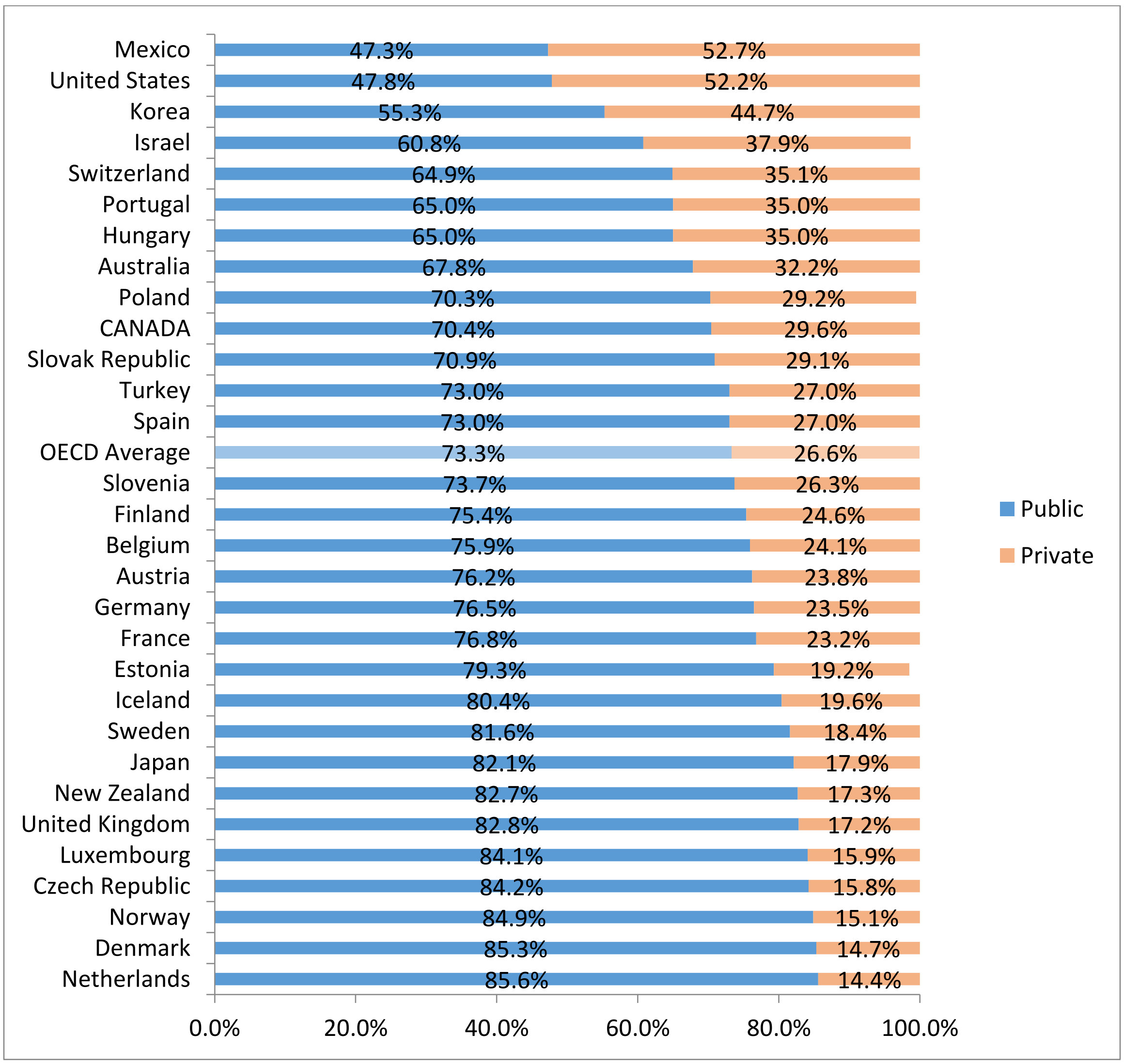
Figure 3
TOTAL HEALTH EXPENDITURE PER CAPITA, U.S. DOLLAR, 30 SELECTED OECD COUNTRIES



Source: National Health Expenditure Trends, 1975 to 2013/OECD Health Data 2013.

Figure 4 presents the total health expenditure by source of financing, Public and Private share. On one side, expenditures by the public sector represented more than 80% of total health expenditures in Netherlands, Denmark, Norway, etc. The country with the lowest public-sector share was Mexico at 47.3%, followed by the United States at 47.8%. The share of total health expenditure funded by the public sector was 70.4% in Canada. The OECD public health expenditure average was 73.3%, and 26.6% for the private share.

Figure 4
TOTAL HEALTH EXPENDITURE PUBLIC AND PRIVATE SHARE, 30 SELECTED OECD COUNTRIES



Source: National Health Expenditure Trends, 1975 to 2013/OECD Health Data 2013.

HEALTH CARE IN CANADA AS PART OF SOCIAL TRANSFER

When we traveled in the US and talked with other academics we heard some strange stories. We've been told that in US, a house owner had to mortgage his house three times: the first one to purchase the house, the second time to pay children education, and the third time, for major medical treatments like knee or hip replacement or hearth problems. Can it be that elderly people work at Wal-Mart only to pay medical bills or medical insurance? We were told that as Canadians, we were lucky because health care is free. If it is free, somebody has to pay for it.

Even Canadians do not know the cost of health care. This occurs partly because Canadians do not incur direct expenses for their use of health care, and partly because Canadians cannot readily determine the value of their contribution to public health care insurance.

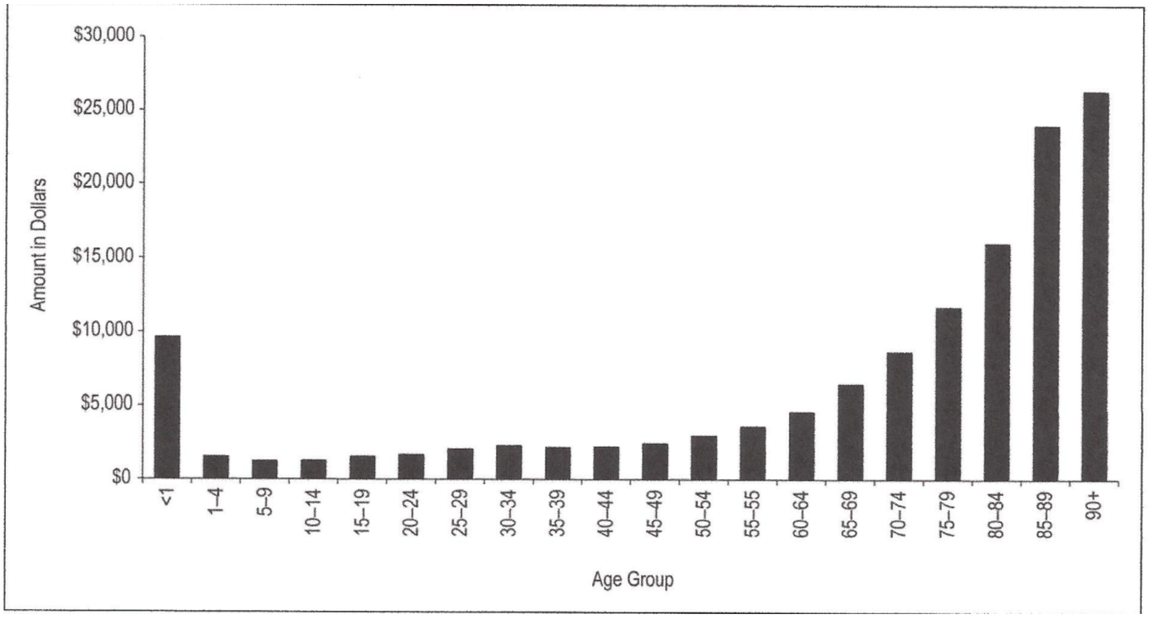
One reason why Canadians don't know the true cost of health care is because the physician and hospital-based services that are covered by the tax-funded health care insurance are free at the point of use. This situation leads many people to grossly underestimate the true cost of health care. When people speak of "free" health care in Canada, they are entirely ignoring the substantial taxpayer-funded cost of the system.

In his book on the Canadian health system, Jeffrey Simpson (2012) stated that health care is straining provincial budgets across Canada. It now takes up to between 42 and 45 percent of provincial program spending, and the percentage is growing. Health care costs have been rising faster than those of any other government programs, faster than government revenues, and faster than economic growth. Before the end of this decade, health care will likely consume more than half of each province's budget. This pattern exists in small and large provinces, in those that have raised taxes or lowered them and in those with centre-left or centre-right governments.

The Globe and Mail reported the same concerns. Health care accounts for 42 cents of every dollar the provinces spend, and even more in some provinces. And those costs are rising at a rate of 6.7 per cent a year, which roughly matches the current escalation in federal transfers. Most provinces are exploring ways to control health care costs. But not fast enough. Nothing will come easily. Left unchecked, any number of factors could bankrupt the Medicare system: aging population growth, inflation, chronic disease, and the increasing use of costly new drugs, procedures and equipment (McKenna, 2012).

Figure 5 presents the Provincial/Territorial Government Health Expenditure per Capita, by age group. Except for the first year of age, this figure shows that health expenditures increase as people get older, and it is increasing exponentially. As a consequence of the population shift and baby boomers turning 65, there is a consequence that an aging population will lead to greater demands for health care services and acceleration in the growth of health spending.

Figure 5
PROVINCIAL/TERRITORIAL GOVERNMENT HEALTH EXPENDITURE PER CAPITA, BY AGE GROUP



Source: National Health Expenditure Trends, 1975 to 2013.

The Canada Health Act imposes a universal coverage for medically necessary hospital and physicians' services in all provinces and territories. Such universal coverage should drive similarities in per capita health expenditures but as we can see in table 2, there are differences in the per capita health expenditure for the provinces and territories, which can be explained by a difference in demographic distribution. For example, the per capita health expenditure in 2011 was $3,443 in Quebec and $10,235 in Nunavut. The data from table 2 also show an annual increase in health expenses from 2008 to 2011, such as indicated at the last column of table 2. As can be seen from the percentage increase, not all provinces were able to contain health care expenses with a total increase varying from 10.9% for Ontario and 31.9% for Prince Edward Island from 2008 to 2011.

Table 2 TOTAL PROVINCIAL/TERRITORIAL GOVERNMENT HEALTH PER CAPITA					
	2008	2009	2010	2011	Percentage change
N.L	3,930 $	4328 $	4763 $	5,061 $	28.7%
P.E.I.	3,108	3635	3,920	4,291	31.9
N.S.	3,459	3,522	3,836	4,073	17.0
N.B.	3,516	3,710	3,887	4,104	16.7
Quebec	3,023	3,215	3,325	3,443	13.9
Ontario	3,297	3,479	3,600	3,657	10.9
Manitoba	3,672	3,944	4,066	4,194	14.2
Saskatchewan	3,694	3,844	4,058	4,287	16.1
Alberta	3,845	3,971	4,432	4,486	16.7
B. C.	3,333	3,397	3,523	3,618	8.6
Y.T	4,663	5,360	5,420	5,846	25.4
N.W.T.	6,374	6,663	6,555	7,200	13.0
Nunavut	8,500	9,199	9,599	10,235	20.4
Canada	3,352	3,520	3,691	3,790	13.0

Sources: National Health Expenditure Trends, 1975 to 2013, computation by the author.

WHO PAYS FOR HEALTH CARE

In their July 2014 Research Bulletin, the Fraser Institute tried to compute the price of Public Health Care Insurance in Canada by family type and by income group. Canadians are not billed directly when they receive health care, and they do not pay a dedicated health tax either. Instead, health care expenses are paid from general revenue which makes it hard to compute the real cost of health care.

In their review of the price of Public Health Care Insurance, the Fraser Institute includes in the total tax bill the income taxes (personal and business); property taxes; sale taxes; payroll taxes; health taxes; import duties; taxes on the consumption of alcohol and tobacco; fuel taxes and motor vehicle licence fees; natural resource fees; and a host of other levies. Table 3 divides Canadians families in 10 income groups, or deciles to show what families from different income brackets will pay for health care insurance in 2014. According to the Fraser Institute, the Canadian families with the lowest income (decile 1) will pay an average total tax bill of $2,148 (16%) and an average health care insurance of $523. On the other side of the spectrum, the 10 percent of Canadian families with an average cash income of $278,012 will pay an average total tax bill of $152,869 (55%) and health care insurance of $37,239.

The rich pay for the poor, and taxation is used as an instrument of attaining certain objectives as a mean of redistribution of wealth and thereby reducing inequalities.

Table 3
AVERAGE INCOME AND TOTAL TAX BILL IN EACH DECILE, 2014 IN CANADA (PRELIMINARY ESTIMATES)

Decile*	Average Cash Income ($)	Average Total Tax Bill ($)	Tax Rate	Health care Insurance ($)
1	13,447	2,148	16.0%	523
2	27,532	5,206	18.9%	1,268
3	37,673	10,129	26.9%	2,467
4	46,774	16,359	35.0%	3,985
5	57,818	22,667	39.2%	5,522
6	70,886	29,766	42.0%	7,251
7	86,235	37,487	43.5%	9,132
8	107,012	47,285	44.2%	11,519
9	137,525	63,382	46.1%	15,440
10	278,012	152,869	55.0%	37,239

Note: *Deciles group families from lowest to highest incomes with each group containing ten percent of all families. The first decile, for example, represents the ten percent of families with the lowest incomes.
Source: The Fraser Institute's Canadian Tax Simulator, 2014.

Source: The Fraser Institute's Canadian Tax Simulator, 2014.

MAJOR FEDERAL TRANSFERS

The Government of Canada provides significant financial support to provincial and territorial governments on an ongoing basis to assist them in the provision of programs and services. There are four main transfer programs: the Canada Health Transfer (CHT), the Canada Social Transfer (CST), Equalization and Territorial Formula Financing (TFF).

The Canada Health Transfer and Canada Social Transfer are federal transfers which support specific policy areas such as health care, post-secondary education, social assistance and social services, early childhood development and child care.

The Equalization and Territorial Formula Financing programs provide unconditional transfers to the provinces and territories. Equalization payments are based on a formula that calculates the difference between the per capita revenue yield that a particular province would obtain using average tax rates and the national average per capita revenue yield at average tax rates. Those transfers enable less prosperous provincial governments to provide their residents with public services that are reasonably comparable to those in other provinces, at reasonably comparable levels of taxation. Territorial Formula Financing provides territorial governments with funding to support public services, in recognition of the higher cost of providing programs and services in the north.

Table 4 presents major transfers as Federal support to the provinces and territories for the year 2013-2014. The first column represents the Canada Health Transfer to each province and territory, which is on per capita basis to provide a universal coverage for medically necessary physician and hospital-based services in all provinces and territories. The second column is for the Canada Social Transfer to each province and territory. The third column, Equalization, is an unconditional transfer for less prosperous provinces and territories to provide their residents with public services comparable across Canada at a reasonable level of taxation. We can observe that six provinces, Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario and Saskatchewan received Equalization payments, and three provinces, Saskatchewan, Alberta and British Columbia did not receive any. Some would say that the richer provinces subsidize the poorer provinces, which involves wealthy provinces making payments to the poor provinces and the money the provinces receive through equalization can be spent in any way the provincial government desires. The payments help to guarantee "reasonably comparable levels" of health care, education and welfare in all the provinces, fighting inequalities and providing social programs to the underserved groups. Such transfers are so important that they represent up to 33% of the provincial budgets in Prince Edward Island and Nova Scotia, and 32% for New Brunswick (see last column of table 4).

In addition to the previous transfers we can observe Territorial transfers in the other column of table 4, which is equivalent to Equalization transfers but for the territories.

Table 4
FEDERAL SUPPORT TO PROVINCES AND TERRITORIES FOR 2013-2014
Major Transfer (millions of dollars)

Provinces/ Territories	Canada Health Transfer	Canada Social Transfer	Equalization	Other	Total Transfer	Per Capita Allocation (dollars)	Percentage of Provincial Budget (%)
Canada	$30,283	$12,215	$16,105	$3,694	**$62,297**	$1,774	19 %
N.L.	490	183	-	-	**673**	1,277	9
P.E.I.	128	50	340	-	**518**	3,569	33
Nova Scotia	830	327	1,458	350	**2,965**	3,150	33
New Brunswick	667	263	1,513	49	**2,492**	3,296	32
Quebec	7,184	2,834	7,833	-	**17,851**	2,191	26
Ontario	11,925	4,704	3,169	-	**19,799**	1,464	17
Manitoba	1,114	440	1,792	7	**3,353**	2,653	24
Saskatchewan	977	385	-	-	**1,361**	1,230	12
Alberta	2,723	1,396	-	-	**4,119**	1,027	11
British Columbia	4,154	1,592	-	-	**5,747**	1,256	13
Yukon	31	13	-	817	**860**	23,566	73
North. Territories	27	15	-	1,070	**1,163**	26,773	72
Nunavut	34	12	-	1,273	**1,396**	39,373	83

CONCLUSION

The purpose of this paper was to study wealth distributions and income inequality. Statistical data analysis shows that income inequality is on the rise but in many countries, governments transfers such as social assistance, unemployment insurance, old age security, and social transfers for education and health programs play an important role in reducing income inequality. Taxation in a responsible government is needed, not only to raise revenues for government operation, but to reduce inequality of income and wealth through social and education programs. Health care in Canada is a good example of social transfer to fight inequalities. Their progressive tax rate system makes that the rich pay for the poor. Canadian families with the lowest income will pay an average total tax bill of $2,148 (16%) and an average health care insurance of $523. On the other side of the spectrum, the 10 percent of Canadian families with an average income of $278,012 will pay an average total tax bill $152,869 (55%) and health care insurance of $37,239.

In addition, the Government of Canada provides significant support to provincial and territorial governments with transfers that enables less prosperous provincial governments to provide their residents with public services to support social programs, thus reducing inequalities and subsidizing social programs that some Canadians could not afford.

However, Canadians are still not satisfied with their health care system. One of the major problems is the waiting time for certain medical procedures. A study by Nadeau and al. (2014) just confirmed Canadians' perception of its health care system. The study finds that both Canadians and Americans are concerned with issues of access. For Canadians, concerns revolve around wait times (equal but slow access). Americans expressed much more concern about financial inequality in access to health care. These differences are to be expected, of course: there are different trade-offs in a Canadian model that provides universal coverage, and an American model ibn which access and income are linked.

But, there are some challenges with the Canadian health system. The first one is the rising cost of the service together with demographic shift which will tax the system even more. The second one is that the Canada Health Transfer (CHT) will continue to grow at six percent, until 2016-17 but starting in 2017-18, the CHT will grow in line with a three-year moving average of nominal gross domestic product (GDP) growth, with funding guaranteed to increase by at least three percent per year. The problem is that the average annual health cost increase was over 5% for most provinces.

ENDNOTES

1. Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Lorenz curve plots the cumulative percentages of total income received against the cumulative number of recipients, starting with the poorest individual or household. The Gini index measures the area between the Lorenz curve and a hypothetical line of absolute equality, expressed as a percentage of the maximum area under the line. Thus a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality. (http://www.nationmaster.com/country-info/stats/Economy/GINI-index)

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ENDORSEMENTS AND TESTIMONIALS IN ADVERTISING – IN THE PERSPECTIVE OF COMPETITION LAW

Liou, Hwa Meei, National Taiwan University of Science and Technology

ABSTRACT

In the internet era, all kinds of online activities, such as word of mouth, articles posted on social websites (e.g. Facebook and Twitter), and blog writers have become the best advertising media. This type of advertisement is made through the opinion expression and recommendation of a third party, and is generally called endorsement and testimonial advertising. Various countries around the world have formulated Competition Law to impose many restrictions on endorsement and testimonial advertising. Articles 21 & 25 of the Fair Trade Act in Taiwan also stipulate endorsement and testimonial advertising-related issues. In addition, Disposal Directions on the Use of Endorsements and Testimonials in Advertising have been formulated since 2006. The main purpose of this study is to investigate how the legal systems in Taiwan, the U.S., Canada, Mainland China, and Germany stipulate endorsement and testimonial advertising, including the principle for disclosure of material connections, whether the material connections are reasonably expected by the general public, the regulations of disclosure methods, definitions and identifiability of endorsement and testimonial advertising, and online endorsement and testimonial advertising. The latest case of endorsement and testimonial advertising in Taiwan currently deemed a violation of Fair Trade Act is a sanction case of unfair competition formed through online word-of-mouth marketing by a foreign company.

INTRODUCTION

Advertising is a common enterprise marketing strategy, and the personal experiences of celebrities, experts, professional organizations, and general consumers are common promotional approaches used by enterprises. In the internet era, all kinds of word-of-mouth marketing, articles posted on social websites (e.g. Facebook and Twitter), and blog writers have particularly become the best advertising media and have affected the life of all the people. This type of advertisement is generally called endorsement and testimonial advertising. Because this form of advertisement is made through the opinion expression and recommendation of a third party, it is different from the advertising marketing approach of traditional advertisers. In terms of the influence on consumers, endorsement and testimonial advertising can more easily gain the trust of consumers than traditional advertising, and can further facilitate consumers' decision on purchasing products and services. Therefore, the legal systems of various countries around the world usually impose restrictions on this type of advertisement.

As endorsement and testimonial advertising is still advertising in nature, various countries have formulated applicable advertising laws and regulations to impose restrictions. Due to the restrictions on False or Misleading Advertising in Competition Law, to date, many countries around the world have developed well-designed Competition Law systems, competent competition authorities, or Competition Law courts, and have accumulated abundant experiences in handling common unfair competition approaches and false or misleading advertising used by enterprises. Legal endorsement and testimonial advertising regarding products or services is a channel that increases positive information sources to consumers, and is beneficial to improving enterprises' profits and turnover. However, if the content of endorsement and testimonial advertising is false, or fails to display information independently or objectively, enterprises may violate Competition Law by using false or misleading advertising.

The following sections of this study investigated how the legal system of Taiwan, the U.S., Canada, Mainland China, and Germany stipulate endorsement and testimonial advertising. The main issues are, as follows: (1) principle of disclosure of material connection– if a certain material connection exists between people engaging in endorsement and testimonial advertising and advertisers, the independence and reliability of endorsement and testimonial advertising will be affected, and such a material connection should be disclosed; (2) whether the material connection of endorsement and testimonial advertising is reasonably expected by general consumers should be disclosed in advertisement; (3) disclosure methods - material connections are legally required to be disclosed, what are the specific disclosure methods, what are the requirements, and how to disclose a relationship for consumers to recognize? (4) definitions and identifiability of endorsement and testimonial advertising - what kind of the opinion expression of third parties online are pure information provision and feedback sharing, or whether they are substantial advertisement and should be stipulated by law; (5) regulations of online endorsement and testimonial advertising - the spreading speed and dimensions of endorsement and testimonial advertising of all kinds of online word-of-mouth marketing, articles posted on social websites, blogs, internet forums, BBS, etc. are different from those of traditional media, such as TV, broadcasting, newspapers. How to regulate it is a common question?

In the last section, this study takes a specific case in Taiwan as the example to explain how the competent competition authority – the Fair Trade Commission, imposes punishments on a foreign company engaging in online endorsement and testimonial advertising in compliance with the Fair Trade Act in Taiwan.

PRACTICES IN TAIWAN

Fair Trade Act

The main laws governing enterprises engaging in advertising marketing activities include the generally applicable Fair Trade Act and Consumer Protection Law, as well as individualized regulations on advertising for specific products, media, and industries, such as food advertisements, drug advertisements, farm produce advertisements, cosmetics advertisements, and TV advertisements. The Fair Trade Act mainly stipulates the legitimacy of use of an advertising engaging in competitive behaviors, while Consumer Protection Law focuses on enterprises' advertising authenticity obligation to consumers. The Fair Trade Act in Taiwan has been enforced for more than 20 years, since 1992, and the latest amendment was made in June 2015. In terms of endorsement and testimonial advertising, no amendment was made.

The regulations governing endorsement and testimonial advertising in Taiwan are stipulated in the Fair Trade Act. This Act includes restraint of competition, monopoly, merger, cartel, advertising, and gifts and prizes belonging to unfair competition. Endorsement and testimonial advertising is one of the forms belonging to "unfair competition." In 2010, the provisions of the second half of Subparagraph 5 and Subparagraph 6, Article 21 were added in the Amendment to Fair Trade Act in 2010. The provisions of proviso of the second half of Subparagraph 5, Article 21 were added to the Amendment in 2011 - Where any endorser provides any testimonials that he knows or should have known would be likely to mislead the public, he shall be jointly and severally liable with the principal of such advertisement for damages arising there from, which belongs to civil responsibility. In terms of administrative responsibility, because those that provide endorsements and testimonials usually do not have the identity of “business”, as stipulated in the Fair Trade Act; therefore, the Fair Trade Act itself does not stipulate the administrative responsibility of fines imposed on those who provide endorsements and testimonials. Instead, another act – the Administrative Penalty Act, where Article 14 stipulates that, if those who provide endorsements and testimonials, and advertisers intentionally violate the provisions of Fair Trade Act, they shall be imposed with the same administrative penalty as the advertisers. Moreover, the Fair Trade Act does not stipulate that criminal liability shall be assumed when endorsement and testimonial advertising violates the law.

As those who provide endorsements and testimonials may be famous public figures, professionals, organizations, and general consumers (Paragraph 2, Article 2 of Disposal Directions on Use of Endorsements and Testimonials in Advertising), it is unfair for those providing endorsements and testimonials with different identities to assume the same civil liability for compensation. Therefore, during the Amendment to the Fair Trade Act in 2011, the liability assumed by those who are general consumers providing endorsements and testimonials was narrowed. However, endorsers who are not celebrities, specialists, or organizations shall be held jointly and severally liable with the advertiser for only up to 10 times the reward they have received from the advertiser.

Disposal Directions

In order to respond to the increasingly diversified marketing approaches of endorsement and testimonial advertising, as well as various new types of online word-of-mouth marketing, the competent authority – the Fair Trade Commission not only enforces the Fair Trade Act, but also formulated explanatory Administrative Rules in 2005 - Disposal Directions on Use of Endorsements and Testimonials in Advertising, which has been amended several times. The most important amendment was made in late 2013. In order to include the pattern of endorsement and testimonial advertising of articles posted on social websites into the scope of the Fair Trade Act, the amendments made under legal systems of different countries, such as the U.S. and Germany, were considered. The focuses of the amendment included: revising the definition of endorsement and testimonial advertising to include the advertising behavior of articles posted on social websites, adding the provision of required disclosure of material connections between those providing endorsements and testimonials and advertisers that is not reasonably expected by the general public, and adding the provision of required disclosure of material connections between those providing endorsements and testimonials in the manner of articles posted on social websites and advertisers that is not reasonably expected by the general public. In addition, those who fail to fully disclose such information in advertising that may affect trade order are involved in breaching Article 25 of the Fair Trade Act. The articles posted on social websites mentioned herein include articles posted by internet bloggers and articles posted in forums.

For example, a certain online message board specifically provides MP3 players for users to discuss new techniques for downloading music. Users of this online message board exchange information on new products, new applications, and new functions of the player. If an employee working for a supplier that plays the leading role in the industry of players, and whose identity is not known to the social website of message board, posts information to promote the products manufactured by the supplier, once it is known that the person posting the information is hired by the supplier, the credibility of his endorsement and testimonial content may be affected. Therefore, the person posting such information should clearly disclose their relationship with the supplier to board members and readers, and the supplier should remind the person posting such information to disclose such a relationship (cited from Disposal Directions on Use of Endorsements and Testimonials in Advertising, 6, Example). Another example is: a certain famous movie star recommends a certain specific product in advertisement, mentions the quality of the product, and his/her personal preference. This endorsement and testimonial advertising certainly must reflect his/her true opinions or experiences. However, because the movie star provides endorsement and testimonial to obtain reward, there exists a material connection between the movie star and the advertiser. Such a relationship is not required to be disclosed, as this reward and material connection are reasonably expected by the audience (quoted from

Disposal Directions on Use of Endorsements and Testimonials in Advertising, 3, Example 6).

Discussion

In terms of practical application, if an individual product or service is regulated by a specific law/act, the Fair Trade Commission will not enforce the regulations on such endorsement and testimonial advertising. The principle – "Special Law is superior to Common Law" will be followed, and the regulations will be enforced by the competent authority under the specific law/act. For example, endorsement and testimonial advertising of food or cosmetics are handled in compliance with the Act Governing Food Safety and Sanitation or Statute for Control of Cosmetic Hygiene enforced by Ministry of Health and Welfare, because compared to the Fair Trade Act, these two laws are "Special Laws", and are superior to the Fair Trade Act. If an individual product or service is not regulated by specific law, it applies to the Fair Trade Act and endorsement and Disposal Directions on Use of Endorsements and Testimonials in Advertising, and will be handled by the Fair Trade Commission.

If the information: "The author was invited by the supplier to share this article" is specified in the article recommending a product on a specific webpage of Facebook, such an article does not violate the Fair Trade Act. If a famous celebrity recommends a product, although there is a material connection between this celebrity and the business, in general, such a material connection can be reasonably expected by the public. Therefore, non-disclosure of the material connection does not violate the Fair Trade Act. To date, there has not been any specific regulation regarding "the way of disclosure" of a material connection between those providing endorsements and testimonials by posting articles online and business in Taiwan. Providing readers can clearly identify that a material connection (e.g. employment and gifts) exists in such endorsement and testimonial advertising, there is no rule stipulating that specific writing methods or notes are required.

PRACTICES IN THE U.S.

The U.S. Competition Law's regulations regarding endorsement and testimonial advertising are stipulated in the Federal Trade Commission Act, Section 5. Specific rules of interpretation are developed at the executive order level of violation of "unfair or deceptive behavior," namely, Guides Concerning the Use of Endorsement and Testimonials in Advertising, as promulgated in 1980 and amended in 2009 (Wu & Shen, 2009).

The FTC's Guides Concerning the Use of Endorsement and Testimonials in Advertising request suppliers to disclose substantial relationships between those providing endorsement and testimonial and those selling the products (§255.5 Disclosure of material connections). The main purpose is to determine whether consumers' trust in those providing endorsement and testimonial is affected. Substantial relationships include recommendations made by recommenders who receive a certain proportion of product sales as a reward (Fan, 1996). In other words, the direct sharing of product sales profits by those providing endorsement and testimonial is a direct financial interest and should be disclosed. Substantial relationships also include the obtainment of a certain benefit of those providing endorsement and testimonial, such as an appearance on television after providing an endorsement and testimonial that is favorable to the advertising of products (§255.5), or when advertisers sponsor research institutes to study their products and claim the research results in the produced and broadcasted advertisement. Such relationships should be disclosed in the advertisement (§255.5 Example 1).

In terms of the principle of disclosure of material connection, movie studios offering film tickets as reward to invite customers to comment on movies should be disclosed (§255.2 Example 7). If consumers can obtain rewards points when explaining products of specific advertisers to friends, and the points can be used to exchange for prizes (e.g. music concert tickets or electronic products), such reward should be disclosed (§255.5 Example 9). If the customers providing endorsement and testimonial for product sales are actually actors/actresses, such a situation should also be disclosed, as audiences cannot expect that the customers providing endorsements and testimonials are actors/actresses (§255.5 Example 6).

The material connection, as reasonably expected by consumers (general public) and movie stars' endorsement and testimonial advertising (e.g. recommendation of a specific food), are not generally required to be disclosed, no matter whether the movie stars receive a cash payment or a premium determined according to the product sales volume. Therefore, such a reward is usually reasonably expected by general consumers (§255.5 Example 2). However, although an endorsement is made by a famous tennis player, if the recommended content is a successful surgical experience of a certain clinic, and the person providing endorsement and testimonial has a contract relationship with clinic, which pays him/her to discuss their surgical experience in public, such a relationship may not be a reasonably expected material connection by consumers (§255.5 Example 3).

Reasonably expected situations may also be different; for example, when a doctor provides endorsement and testimonial advertising for products treating snoring; although consumers can expect that the doctor may obtain payment for such advertising, the doctor actually obtains payment according to the proportion of product sales or is one of the shareholders. The said two situations cannot be reasonably expected by consumers. Such a unique material connection between a pharmaceutical company and a doctor should be disclosed in advertising (§255.5 Example 4).

Regarding the definitions of endorsement and testimonial, if the advertising spokes people do not express personal experiences, but only speak for products/services from the perspective of advertisers, such advertising is not viewed as endorsement and testimonial advertising (§255.0 Example 3). Endorsement and testimonial advertising may not necessarily be verbally stated by those providing endorsements and testimonials in advertising. The TV images of golfers swinging clubs may also be endorsement and testimonial advertising (§255.0 Example 5). Pure sharing of feedback regarding the advantages of a new pet food different from those of other pet foods purchased in the past by consumers, and written about in a blog, is not endorsement and testimonial advertising (§255.0 Example 8).

Regarding free samples, according to the situations, free samples may be or may not be endorsement and testimonial advertising. For example, (§255.0 Example 8) suppliers regularly track consumers' purchase records, and their computer automatically produces coupons for free product samples. At this moment, a blogger would not be viewed as those providing endorsement and testimonial advertising. However, if bloggers receive free samples of new products provided by advertisers to write articles in their blogs, and they do not clearly disclose the fact that they are rewarded for their product recommendations, they violate the Guides (§255.1 Example 5).

Regarding disclosure methods, while the Guide stipulates that disclosure should be “clear and conspicuous,” specific form or text is not required. For example, endorsers may specify “Company A provides me with samples” or state “A part of the products used in this video is provided by sponsors” at the beginning of an advertising video (instead of the end of video). No matter whether endorsers obtain US$50 or US$100 as a reward, only the information of the reward for those providing endorsement and testimonial is required to be briefly specified. However, if those providing endorsement and testimonials are employees or shareholders of advertisers, the disclosure of the fact that “they are rewarded” is insufficient. It is improper to disclosure information via a hyperlink, as consumers may not necessarily click the website link. It is also improper to disclosure information hidden in the footnotes of articles. Disclosure methods are assessed according to general judgment principles, no matter whether online or traditional advertising is used: It is necessary to enable consumers to obtain information required for assessing such sponsored opinion expression. Disclosure methods should enable consumers to notice the disclosed content easily, and without additional searching for relevant information (the spirit of disclosure in the U.S. is the same as that in Canada, as described in the following section). In addition, descriptions comprehensible to consumers should be used (FTC,2015).

Regarding the disclosure of online endorsement and testimonial advertising, the FTC has also released Endorsement Guides (FTC, 2013). The focuses include: The disclosure of online endorsement and testimonial advertising should be “clear and conspicuous.” Advertisers should also consider where disclosure is placed in the advertising, and it is preferable to place the disclosure closer to the advertising. Moreover, it is also necessary to consider the significance of disclosure, whether other parts of the advertising will distract attention from the disclosed content, whether the disclosure is displayed using proper volume and rhythm, whether video disclosure is displayed for sufficient amount of time, and whether the language used for disclosure is comprehensible to the audiences.

PRACTICES IN CANADA

The Canada Competition Law (Competition Act) was formulated and promulgated in 1985, and the latest amendment was made in March 2015. Canada established a specific Competition Law Court (Competition Tribunal). Regulations for False or Misleading Representations include civil and criminal liability. Criminal liability is stipulated in Article 52 (1) of the Competition Law, while civil liability is stipulated in Article 74.01 (1) (a). Article 52 (1) stipulates that no person shall, for the purpose of promoting, directly or indirectly, knowingly or recklessly make a representation to the public that is false or misleading in a material respect. The “material” dimension usually refers to whether the representation of advertising is able to affect consumers’ purchase of a product or service. The content of Article 74.01 (1) (a) is generally the same. To determine whether or not the representation in advertising is false or misleading, the so-called “general impression test” is used (see Article 52(4) and/or Article 74.03 (5)). In addition to the provisions of false advertising, the Competition Law also regulates applicable laws and regulations of consumer protection and product labeling. False or misleading representation may be associated with a supplier or the business entity of a supplier, product, and price. Endorsement and testimonial advertising belongs to product-related false advertising and is regulated by Article 52 (1) and/or Article 74.01 (1) (a) of the Competition Law.

Regarding an undisclosed material connection, a third party may be used to express opinions in advertising, and there may be an undisclosed connection between the third party and advertiser or its product. For example, the third party is a shareholder or employee of the company of the advertising representation, or the third party is a supplier of the advertiser or the implied independent testing institution, or the organization that is actually sponsored or controlled by the advertiser. The said factors should be considered even though the opinions expressed by the third party are not affected by these factors. Because the public attach importance to such advertising, not only for the reputation of the conditions of the third party, but also for its independence, or partiality may occur (Competition Bureau, False or Misleading Representations, 2.1.4).

For a reasonably expected material connection, if opinions in advertising are provided by celebrities, the public usually can reasonably expect that the celebrities are rewarded or involved in other interests. Under such a situation, non-disclosure of reward relationship will not be misleading; however, there are exceptions. If an advertising forum displays that the third party voluntarily provides his/her service (out of the concern over the reduced quality standard of a certain industry), or advertising representation implies that the third party provides his/her professional opinions for free, such material connection should be disclosed (Competition Bureau, False or Misleading Representations, 2.1.5).

Regarding disclosure methods, in 2009 the Competition Bureau in Canada newly amended the Enforcement Guidelines of Competition Law that apply to the implementation of online advertising (The previous version of the Enforcement Guidelines was formulated in 2003). The Enforcement Guidelines are provided for reference only, and do not restrict the judgment of the Commissioner of Competition. Although the Enforcement Guidelines are not directly formulated for online endorsement and testimonial advertising, some principles regarding the disclosure of false advertising are clarified. As online advertising is similar to a mail-order purchase, where consumers cannot actually inspect the product, consumers are highly dependent upon advertising representation. To ensure that advertising representation is real, and not false or misleading, unlike other laws in Canada, the Canada Competition Law does not generally stipulate the unique information required to be disclosed. While this is a general principle, there are also several exceptions, such as the multi-level marketing plans stipulated in Article 55 of the Competition Law. From the standpoint of the Competition Bureau, the specific disclosure method is: all required disclosures should be likely to be read as much as possible.

Whether the context of online advertising representation is properly disclosed will be dependent upon the format and design of the Web site. For example, readers (consumers) should not be requested to take an active step (e.g. sending an email or making a phone call) to obtain the information that is required to be disclosed. If consumers are requested to click a clearly marked hyperlink, whether it should be viewed as an "active step" is determined by the Competition Bureau according to different situations (Enforcement Guidelines, 4.2).

Regarding how to determine whether information is sharing of feedback or endorsement and testimonial advertising, one of the most beneficial methods for online consumers is to use wireless internet to obtain various kinds of new information to make purchase decisions, including articles, reports, experts' perspectives, or experiences of other consumers. However, under many situations, advertisers' design of online product or service advertising makes advertising appear different from marketing material. For example, some online advertising look like fair news articles or news headlines, some look like independent information sources (e.g. experts' opinions or blog's opinions), and some commercial advertising representation imitate consumers' opinions or endorsement and testimonial. When online advertising is falsely viewed as independent information, it will be severely misleading (Competition Bureau, The Deceptive Marketing Practices Digest, Bulletin, 1.4.).

PRACTICES IN CHINA

The competition laws in Mainland China include the Anti-Monopoly Law formulated in 2007 and enforced in 2008, as well as the Anti-Unfair Competition Law promulgated and enforced in 1993. Anti-Unfair Competition Law was drafted in 1987 and promulgated and enforced in 1993. To date, the Anti-Unfair Competition Law has not been amended. However, relevant amendments and corrections have been initiated since 2003, and it is expected that the first Amendment to the Anti-Unfair Competition Law will be initiated soon. The provision regarding false advertising is stipulated in Article 9 of the Anti-Unfair Competition Law, and its content is: Managers shall not use advertisements or the other methods to make a false propaganda for the quality, composition, function, usage, producer, time of efficacy, and place of production of commodities. Advertising company shall not be an agent of, or design, or make, or propagandize false advertisement, if it knows or should know the truth.

In addition to the said Anti-Unfair Competition Law, the main laws regulating advertising is Advertising Law. Advertising Law in Mainland China was formulated in 1994, and the latest Amendment was made on April 24, 2015, and enforced on September 1 of the same year. Endorsement and testimonial advertising is mainly regulated by Advertising Law. In addition to Advertising Law, the Food Safety Law, as enforced in 2009, stipulates food endorsement advertising, and the Consumer Rights Protection Law, as newly amended in 2014, also stipulates the endorsement advertising of products or services related to consumers' life and health.

The definition of endorsement and testimonial advertising (endorsement advertising in Mainland China is stipulated in Article 2 of Advertising Law): Endorser in this Law shall mean a natural person, legal person, or other organization, other than the advertiser, that recommends and testifies for commodity or service in their own name or image. The principles of the authenticity of advertising (including the authenticity of endorsement and testimonial advertising) are stipulated in Article 4 and Article 28 of the Advertising Law. The provisions of Article 4 are under Chapter 1 General Provisions, and the content is: Advertising should not contain false or misleading content, or cheat or mislead consumers. Advertiser shall be responsible for the truthfulness of the advertising content. The provisions of Article 28 are under Chapter 2 Principles on Content of Advertising, and are the exemplary provisions on false advertising (false advertising in Mainland China), including 4 examples and one general provision.

Advertising Law includes several unique provisions of endorsement advertising, namely, endorsement and testimonial advertising are prohibited for use in the marketing of products or services with specific themes, including the advertising of medical treatments, pharmaceuticals, medical devices, health foods, pesticides, veterinary drugs, feed and feed additives, education and training, products or services from which merchants are expected to obtain return from investment, crop seeds, tree seeds, grass seeds, breeding livestock, poultry, aquatic fingerlings, and species breeding.

Regarding the identifiability of advertising, whether representation is a pure provision of information (knowledge), or actual advertising marketing as stipulated in Article 14 of the Advertising Law. In other words, advertising should be identifiable to enable consumers to identify whether it is advertising. Mass media cannot launch advertising in the form of a news report. “Advertising” should be explicitly marked in advertising launched through mass media to separate it from other non-advertising information in order to avoid misleading consumers.

Advertising Law also directly applies to the management of online advertising (including endorsement and testimonial advertising). In compliance with the provisions of Article 44: The provisions of this Law shall apply to advertising activity using the Internet. When Advertising Law was formulated in the early days, the internet was not a media of advertising. Therefore, the original Advertising Law only stipulates the advertising of traditional media, such as broadcasting, TV, and newspaper. However, the rapid development of the internet creates extreme challenges for Advertising Law. Some people suggested that a specific law should be formulated for internet advertising. For example, in terms of the identifiability of advertising, although Advertising Law specifically stipulates that advertising should be identifiable to enable consumers to identify whether it is advertising. However, on the internet, there is a large amount of advertising launched in the forms of news, BBS forum, or search engines, which may significantly mislead consumers (people.cn, 2015). However, this Amendment to the Advertising Law confirms that various provisions of Advertising Law directly apply to online advertising.

Regarding the provisions of endorsement and testimonial advertising behaviors, the most important provision is Article 38, and its content is: When an endorser recommends or testifies for a commodity or service in advertising, he or she should refer to facts, comply with the provisions of this Law and other laws and regulations, and should not recommend or testify for a commodity or service that he or she has not used. This provision is close to the spirit of that in the U.S. Regarding the eligibility of endorsers, there are also two restrictions in Advertising Law: 1. A minor under the age of 10 should not be used as Endorser; 2. A natural person, legal person, or other organization that received administrative penalty for recommending or testifying in false advertising in the last three years should not be hired as Endorser. Moreover, the legal obligations to be assumed by hired advertising endorsers are stipulated in Article 33: When an Advertiser or Advertising Operator uses another person’s name or image in the advertising, prior written consent should be obtained. The principle of disclosure of material connection of endorsement and testimonial advertising is not stipulated in Advertising Law. However, considering the fact that endorsers’ failure to disclose a material connection may mislead consumers into making a purchase decision, whether Paragraph 5 of the said Article 28: Other situations in which false or misleading content is used to cheat or mislead consumers applies to it is uncertain.

There are two provisions in the responsibilities of endorsers in the Advertising Act: 1. Endorsers shall assume joint liability with advertisers for damages to consumers. Therefore, such joint liability can be divided into two types: civil joint liability without fault, and civil joint liability with fault. 2. Illegal income shall be confiscated and a fine shall be imposed.

One of the focuses of the Advertising Law newly amended in Mainland China this year is regarding improving the system of endorsement and testimonial advertising, and legal liability of those providing endorsements and testimonials. Before this Amendment, Advertising Law only stipulated three main entities: advertisers, advertising operators, and advertising publishers, and advertising endorsers are not the legal entity of advertising activities. This Amendment includes advertising endorsers as the legal entity of Advertising Law (Liu, 2015).

PRACTICES IN GERMANY

Competition laws in Germany are divided into the Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen, GWB) and the Act against Unfair Competition (Gesetz gegen den unlauteren Wettbewerb, UWG). UWG was formulated in 1909, and the latest Amendment was made in 2013. The provision on false advertising is stipulated in Article 5 of UWG. Basically, civil liability is adopted, which is different from that in GWB. The provision of false advertising includes endorsement and testimonial advertising-associated patterns: advertising produced according to the opinions expressed by the third party (Werbung mit Äußerung Dritter), advertising using appraisal opinions, advertising using academic articles, or advertising using recommendations of other people or organizations. In general, the use of opinions expressed by a third party can better attract the attention of consumers than the use of advertisers' own representation. Whether the third party agrees with advertisers' use of his/her recommendation letter in advertising is irrelevant to whether the advertising is misleading (Köhler&Bornkamm,2012).

Regarding the principle of disclosure of a material connection of endorsement and testimonial advertising, competition laws in Germany are different from those in the U.S. and Taiwan. Competition laws in Germany do not formulate specific interpretative rules, but make judgments according to the accumulation of practical experiences of court judgments. For example, OLG Hamburg (GRUR1979, 246, 248) pointed out that, the use of a paid recommendation letter is prohibited if such material connection is not clearly disclosed. The material connection, which can be reasonably expected by the general public, is not required to be disclosed. For example, if recommendations are made by celebrities (e.g. famous athletes or actors), the general public can reasonably expect that these celebrities will not usually provide their names or images for advertising for free. The same principle applies to recommendations made by organizations. In other words, a material connection should be disclosed unless general public can reasonably expect the relationship of paid recommendation; otherwise, failure to disclose such a relationship is a breach of law (Köhler/Bornkamm, a.a.O., Rn 2.164). Regarding disclosure methods, disclosure should be made clearly, and in a manner that is identifiable to consumers (eine für den Verbraucher erkennbare Weise) (Weiß, 2014).

The judgment of the Hamm High Court (OLG Hamm, 23.11.2010 1-4U 136/10) in 2010 also pointed out that: For advertising made through customers' recommendations (Kundenempfehlungen), such customers' judgments basically cannot be bought (erkauft). When paid recommendations are used (bezahlte Zuschriften) (in this case, endorser providing a comment openly can obtain a discount), the use of such recommendations are illegal if such material connection is not clearly disclosed. Similar cases are also found in judgments of the Hamm High Court in 2013 (OLG Hamm, Urteil vom 10 September 2013 – Az. 4U 48/13).

Based on the above, paid recommendations may not necessarily violate Competition Law; however, only when paid recommendations are unidentifiable in advertising (nicht erkennbar) will they be deemed in violation of UWG.

THE CASE OF SAMSUNG

The following case content is quoted from FTC in Taiwan

The FTC decided at the 1146th Commissioners' Meeting on Oct. 23, 2013 that Samsung Taiwan (hereinafter referred to as Samsung) and its sales agents OpenTide Taiwan Co., Ltd. (hereinafter referred to as OpenTide) and Shang Duo Li International Co., Ltd. (hereinafter referred to as Shang Duo Li) had violated Article 24 of the Fair Trade Act by pretending to be private individuals to promote Samsung's products online by comparing and commenting on the products of Samsung's competitors. The FTC ordered the companies to immediately cease the unlawful act the day after receiving the disposition, and also imposed administrative fines of NT$10 million on Samsung, NT$3 million on OpenTide, and NT$50,000 on Shang Duo Li. When signing the annual contract each year between 2007 and 2012, Samsung and OpenTide would decide the projected number of statements to be released. Then, according to the targets achieved and status of execution, OpenTide would present to Samsung weekly and monthly reports on the overall operations, results of handling of critical issues, lists of weekly topics, numbers of articles posted, viral management achievements, outlines of responses to positive/ negative comments, and operating plans for the following week, in order that Samsung could be updated on the execution status and determine measures to be taken against marketing crises. The methods of execution included hiring large numbers of bloggers and appointing company employees to use personal accounts or communal accounts provided by the company to post comments as private individuals on online discussion platforms, such as Mobile 01 and others, to help market Samsung's products. The statements were posted to report new product test results, neutralize negative information regarding Samsung products, or compare and expose the defects of products from competitors. Such statements were presented as articles to share information with net users, or unboxing or inquiring articles about new products or user comments to draw attention and create discussion topics. The hired or appointed personnel were requested to post a certain number of articles each month to help increase the visibility of Samsung's products, and Open Tide also commissioned Shang Duo Li to run the operations for some time during 2012. As a result of their habitual use of online information, some consumers would take the user experiences of other consumers into account when considering purchasing certain commodities. Therefore, such comments posted by people hired by, or associated with, a business were meant to affect consumers' decisions to purchase certain products. By concealing their true identity, the people posting the comments misled consumers into believing that the comments did not come from any business, and thus, increased the credibility of the statements.

Meanwhile, the competitors were also unsure whether the comments had come from a business rival or consumers. Out of their respect for freedom of speech, as well as their fear of the consequences of offending consumers, the competitors were unable to rebuke the comments or resort to administrative or judicial procedures, as they normally would when knowing such comments had come from a business rival. Hence, the marketing approaches adopted by Samsung and the two other companies to draw interest, create discussion topics, and assign people to assume several identities each and take turns to use the same communal accounts to publish statements to win the trust of net users, were meant to deceive consumers or at least conceal their true identity to promote the products of a business. Such deceptive conduct was able to affect the trading order in violation of Article 24 of the Fair Trade Act (FTC, 2014).

Case Analysis

The case of Samsung's Paid Bloggers is the first endorsement and testimonial advertising of posting articles on social websites to be punished by the FTC in Taiwan. The main reasons for punishment is that the hidden career identity and non-disclosure of endorsement and testimonial advertising of a material connection directly or indirectly misled the trade decisions of a potentially large number of consumers, as they were not aware that the online statements were actually the marketing strategies of the business, and thus, the reliability of statements online in the social websites was improperly increased. In terms of competitors, because they were unable to know that the statements were made by competitors or consumers' free speeches, they could not refute the statements. Such an advertising pattern improperly affected industry competition and was sufficient to affect trade order. Therefore, it was a breach of the Fair Trade Act.

CONCLUSION

Endorsement and testimonial advertising is regulated in the competition law systems of various countries. Articles 21 & 25 of the Fair Trade Act in Taiwan stipulate endorsement and testimonial advertising-related issues. In addition, it set up an explanatory executive order in 2006 to emphasize that the content of endorsement and testimonial advertising should not be misleading. A material connection, such as employment, gift, and reward, between those providing endorsements and testimonials and advertisers should be explicitly disclosed in advertising. Regarding the liability to be assumed by those providing endorsements and testimonials, they mainly must assume civil liability for compensation. Regarding administrative liability, because the Fair Trade Act applies to business, those providing endorsements and testimonials whose identity is not business (e.g. general consumers and professionals) can only have punishment imposed in compliance with the Administrative Penalty Act. In Taiwan, at present, there are only two cases of endorsement and testimonial advertising deemed in violation of the Fair Trade Act. One is a case of traditional endorsement and testimonial advertising – a movie star endorsed bamboo sculpting clothing; the other is the latest and only case regarding punishment for online word-of-mouth marketing of a foreign company, which violated the principle of the disclosure of material connection for endorsement and testimonial advertising. The fine was as high as NTD$ 10 million (approximately USD$ 330,000).

Regarding the several issues mentioned in the introduction of this study, the regulations of various countries are, as follows: (1) principle of disclosure of material connection. There are explicit provisions in the competition laws of the U.S., Canada, Germany, and Taiwan – when there is a certain material connection between those providing endorsement and testimonial advertising and advertisers, such a interest relationship is called a material connection according to the laws in the U.S., Payment of the endorser in Canada, and paid recommendation (bezahlte Empfehlungen) in Germany, and should be disclosed in advertising. Failure to disclose such a relationship is deemed in violation of the Competition Law; (2) whether a material connection is reasonably expected by the general public. There are explicit provisions in the competition laws of the U.S., Canada, Germany, and Taiwan – although those providing endorsements and testimonials (e.g. famous athletes or actors) are rewarded, such material connection is reasonably expected by general consumers, and thus, is not required to be disclosed in advertising. However, it is necessary to disclose such material connection, when the recommended content of recommendations made by celebrities is not reasonably expected by the public (e.g. successful surgical experience), or if advertising representation implies that the third party provides his/her professional opinions for free; (3) disclosure method. Competition laws in the U.S. stipulate that the disclosure method should be clear and conspicuous, the Competition Bureau in Canada requests that the disclosure method should be likely to be read. In practice, Germany suggests that information should be disclosed in a manner that is identifiable to consumers. Taiwan will also consider the approaches of various countries in the future to determine whether the disclose method meets requirements; (4) definition and identifiability of endorsement and testimonial advertising. Endorsement and testimonial advertising may be consumer endorsements, expert endorsements, endorsements by organizations, or a prominent figure. Therefore, endorsement and testimonial advertising should be identifiable to allow consumers to identify that it is advertising (instead of general news), which is explicitly stipulated in the Advertising Law of Mainland China. A similar principle of identification also exists in Taiwan. For example, simply clicking Like or checking-in on Facebook will not be viewed as endorsement and testimonial advertising; (5) Provisions of online endorsement and testimonial advertising. The U.S. formulated official Guides, Canada formulated Enforcement Guidelines, and Mainland China formulated Advertising Law, which directly apply to internet advertising. Taiwan also formulated Disposal Directions.

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