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# AMERICANS DON'T HATE TAXES, THEY HATE *PAYING* TAXES

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## I. INTRODUCTION

Americans hate taxes. The burden of supporting wasteful government programs is too much to bear, far exceeding the burden in other countries, at least according to politicians, pundits, and pollsters,<sup>1</sup> as well as ascendant Tea

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<sup>1</sup> See e.g. Mark Murray, "NBC/WSJ Poll: Nearly 60% Approve of Tax Deal", *NBC News* (15 December 2010), online: <<http://firstread.msnbc.msn.com>>; Jon Cohen, "Washington Post-ABC News Poll Finds Broad Bipartisan Support for Tax Package", *Washington Post* (13 December 2010), online: <<http://www.washingtonpost.com>>; PEW Research Center, *Tax Deal Wins Broad Bipartisan Support* (13 December 2010), online: <<http://pewresearch.org>>; Daniel J Mitchell, *Encouraging Polling Data on Spending Restraint vs. Deficit Reduction*, *Cato Institute* (12 December 2010), online: <<http://www.cato-at-liberty.org>>; Lydia Saad, "Americans Support Two Major Elements of Tax Compromise", *Gallup* (8 December 2010), online: <<http://www.gallup.com>>; Sam Stein, "White House Privately Pushing Data Showing Bush Tax Cut Extension Politically Popular", *Huffington Post* (8 December 2010), online: <<http://www.huffingtonpost.com>>; Brian Riedl, "Fiscal Commission Report: Too Much Taxes, Not Enough Spending Cuts", *The Heritage Foundation* (3 December 2010); Mark Berman, "Ron Paul: I Want to Eliminate Income Taxes," *Opposing Views* (2 December 2010), online: <<http://www.opposingviews.com>>; Curtis Dubay et al, "Routine Tax Extenders Package Contains New Irresponsible

Party “patriots”.<sup>2</sup> The same rhetoric animates the propaganda of anti-tax fomenters since the founding of the republic.<sup>3</sup> After all, the birth pangs of the United States originated in the Boston Harbor with a protest over heavy taxation on imported British tea.<sup>4</sup>

It turns out that none of the foregoing is true. Total tax revenue as a percentage of gross domestic product in the United States ranks near the bottom among industrialized countries (indeed, in 2008 it ranked thirtieth among the thirty-three countries comprising the Organization for Economic Cooperation and Development).<sup>5</sup> It boasts equally unimpressive remittances for taxes on goods and services (last among OECD countries) as well as for

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Spending and Tax Hikes”, *The Heritage Foundation* (25 May 2010); Associated Press, “Palin Rips Taxes with Boston Tea Partiers”, *MSNBC.com* (14 April 2010), online: <<http://www.msnbc.msn.com>>.

<sup>2</sup> See Ezra Klein, “Feeding the Beast: Will the Tea Party Really Trim Spending?”, *Newsweek* (20 September 2010), online: <<http://www.newsweek.com>>; Byron Tau, “Contract From America’ Unveiled at DC Tea Party”, *AOL News* (15 April 2010), online: <<http://www.aolnews.com>>; Brian Montopoli, “Katie Couric Interviews Tea Party Leaders”, *CBS News* (25 January 2010), online: <<http://www.cbsnews.com>>.

<sup>3</sup> See Charles Adams, *Those Dirty Rotten Taxes: The Tax Revolts That Built America* (New York: Simon & Schuster, 1998). Despite some episodes of tax resistance, Americans have historically paid their taxes willingly, if unhappily: see Isaac William Martin, *The Permanent Tax Revolt: How the Property Tax Transformed American Politics* (Stanford: Stanford University Press, 2008); Marjorie E Kornhauser, “Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America” (2002) 50:3 *Buff L Rev* 819; Marjorie E Kornhauser, “For God and Country: Taxing Conscience” [1999] 5 *Wis L Rev* 939; Alfred F Young, *The Shoemaker and the Tea Party: Memory and the American Revolution* (Boston: Beacon Press, 1999); Arthur O’Sullivan, Terri A Sexton & Steven M Sheffrin, *Property Taxes and Tax Revolts: The Legacy of Proposition 13* (Cambridge: Cambridge University Press, 1995); David T Beito, *Taxpayers in Revolt: Tax Resistance during the Great Depression* (Chapel Hill: University of North Carolina Press, 1989).

<sup>4</sup> See Amity Shlaes, *The Greedy Hand: How Taxes Drive Americans Crazy and What To Do About It* (New York: Random House, 1999) at 8; Adams, *supra* note 3.

<sup>5</sup> See OECD.StatExtracts, *Revenue Statistics: Comparative Tables*, online: <<http://stats.oecd.org>>.

taxes on employees (below average).<sup>6</sup> Even with respect to taxes on income, profits, and capital gains, the United States is below the OECD average.<sup>7</sup>

In addition, the United States is decidedly ungenerous in supporting “wasteful” social programs. As a percentage of GDP, the US resides near the bottom quarter of OECD countries in total social expenditures (based on 2007 data).<sup>8</sup> In 2010, the US federal budget crested \$3.5 trillion, with twenty per cent of the pie going to defense and security, another twenty per cent allocated to Social Security, and twenty-one per cent funding Medicare, Medicaid, and CHIP (Children’s Health Insurance Program).<sup>9</sup> Meanwhile, social safety net programs—which in 2009 kept more than twenty million Americans out of poverty and reduced its depth for another thirty million<sup>10</sup>—comprised just fourteen per cent of national expenditures.<sup>11</sup> Moreover, the “welfare waste” that anti-tax, anti-government ideologues argue threatens to bankrupt the nation barely registers as a line item. Indeed, in 2010, the largest such program, Temporary Assistance for Needy Families (TANF), provided a grand total of \$17.1 billion to states, territories, and eligible Native American tribes to support millions of low-income families.<sup>12</sup>

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<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*

<sup>8</sup> See OECD.StatExtracts, *Social Expenditure—Aggregated Data*, online: <<http://stats.oecd.org>>.

<sup>9</sup> Center on Budget and Policy Priorities, *Policy Basics: Where Do Our Federal Tax Dollars Go?* (Washington, DC: CBPP, 15 April 2011) [CBPP, *Basics*] at 1.

<sup>10</sup> *Ibid.* at 2. See also Arloc Sherman, *Safety Net Effective at Fighting Poverty, But Has Weakened for the Very Poorest* (Washington, DC: CBPP, 6 July 2009); Arloc Sherman, *Stimulus Keeping 6 Million Americans Out of Poverty in 2009* (Washington, DC: CBPP, 9 September 2009).

<sup>11</sup> CBPP, *Basics*, *supra* note 9 at 2. These safety net programs include refundable portions of the earned-income and child tax credits, Supplemental Security Income for the elderly and disabled, unemployment insurance, Food Stamps, Head Start, school meals, foster care, adoption assistance, low-income housing assistance, subsidies for child care and home energy costs, and programs that help abused and neglected children.

<sup>12</sup> See Department of Health and Human Services, *Fiscal Year 2010 Budget in Brief: Administration for Children and Families: Entitlement Spending*, online: <<http://hhs.gov>>.

That figure represents just 0.004 per cent of the federal budget, or forty-one times smaller than annual defense appropriations.<sup>13</sup>

And what of our tea-drinking ancestors? As much as these “patriots” want us to believe (and themselves believe) that the United States has been a nation of tax protestors from the very beginning, their understanding of history is as deficient as their math. Indeed, “the destruction of the tea”, as the event was known before nineteenth century propagandists dressed it up for posterity,<sup>14</sup> was never a protest against excessive taxation per se.<sup>15</sup> In fact the entire episode—donning Native American garb, smearing ash on colonial faces, and dumping British tea into Boston harbor—was precipitated by a tax *cut*, not a tax hike.<sup>16</sup> The colonists were not protesting taxation, but rather taxation without representation, “an entirely different matter”, historian T.H. Breen reminds us.<sup>17</sup> Another historian, Joe Thorndike, adds that the colonists “were making a point about political legitimacy. They were more than willing to pay taxes imposed by their own representatives. But they were ut-

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<sup>13</sup> CBPP, *Basics*, *supra* note 9 (based on an annual defense budget of 705 billion dollars).

<sup>14</sup> See TH Breen, *American Insurgents, American Patriots: The Revolution of the People* (New York: Hill and Wang, 2010).

<sup>15</sup> See Joseph J Thorndike, “Four Things You Should Know About the Boston Tea Party”, *Tax Notes* 127:2 (8 April 2010) 141 [Thorndike, “Four Things”] at 142.

<sup>16</sup> Properly set in historical context, the Boston Tea Party represents the climax of a protracted protest against British taxation in the North American colonies. The unrest originated in the mid-1750s with the French and Indian War (a.k.a. the Seven Years’ War or the War of Conquest), which saddled Britain with a mountain of debt. At war’s end, Parliament enacted a series of taxes, all of which the colonists opposed on grounds that the Crown could only impose levies to regulate trade. Parliament capitulated to each of these complaints, and repealed all the taxes except those on tea. The colonists took neither to the streets nor the harbor immediately. But see Young, *supra* note 3: in 1773, Parliament repealed one of the taxes on tea imported to England, which was immediately reshipped to the colonies, while preserving the tax on tea imported directly to North America, a decision that resulted in a tax cut on colonial tea. Nonetheless, colonists resented the special exemption for the British tea importer, East India Company, and thus dumped the more affordable imported tea into Boston Harbor.

<sup>17</sup> TH Breen, “Whose Revolution Is This?”, *Washington Post* (31 March 2010) A17 [Breen, “Whose Revolution?”].

terly unwilling to pay taxes imposed by Parliament".<sup>18</sup> Even so, the colonists continued paying taxes levied by the Crown. But rather than remitting them to British tax officials, they paid non-loyalist tax collectors. "Anyone who misses this point", Breen warns, "risks missing the fact that ordinary American patriots accepted the legitimate burdens of supporting a government in which they enjoyed genuine representation".<sup>19</sup>

Modern-day Tea Partiers demonstrate no better command of recent history than ancient history. Between 2009 and 2010, while these "patriots" railed against excessive taxation, the Obama administration cut taxes (twenty-five different taxes, in fact) for ninety-five per cent of Americans.<sup>20</sup> Yet when queried whether the administration had in fact "increased taxes for most Americans, decreased taxes for most Americans, or . . . kept taxes the same for most Americans", a staggering forty-four per cent of respondents who identified themselves as supporters of the Tea Party movement told pollsters that taxes had gone up, while another forty-six per cent said taxes had remained the same. Only two per cent responded correctly that taxes had in fact gone down.<sup>21</sup>

These folks are clearly confused, or at least misinformed. They understand neither their own anti-tax creation myth nor the effect of national policies on their pocketbook. And they certainly lack almost any resemblance to the patriots they invoke. Nonetheless, modern-day Tea Partiers share one thing in common with their purported ancestors: they are angry and disaffected. They report animosity toward Washington, the President, Congress, and policies they perceive as "disproportionately directed at help-

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<sup>18</sup> Thorndike, "Four Things", *supra* note 15 at 142.

<sup>19</sup> Breen, "Whose Revolution?", *supra* note 17.

<sup>20</sup> Robert Hendin, "Poll Reveals Most Americans Don't Know They Got a Tax Cut", *CBS News* (12 February 2010), online: <<http://www.cbsnews.com>>. In fact, according to a study conducted by the organization Citizens for Tax Justice, the Obama administration cut taxes for ninety-eight per cent of working people in 2009. See Steve Wamhoff, *President Obama Cut Taxes for 98% of Working Families in 2009* (13 April 2010), online: <<http://www.ctj.org/obamastaxcuts.php>>; The White House, *Taxes*, online: <<http://www.whitehouse.gov>>.

<sup>21</sup> Hendin, *supra* note 20.

ing the poor rather than the middle class or the rich.”<sup>22</sup> They are not anti-government per se, as they support Social Security and Medicare among other entitlement programs. But they think they pay too much for what they receive.<sup>23</sup>

Most importantly, modern-day Tea Partiers believe their opinions are neither heard nor represented in Washington. As part of feeling ignored and deprived of government’s spigot, they decry the special-interest, “loophole-ridden tax code,” and consider it “Exhibit No. 1 in their indictment of American government.”<sup>24</sup> In this way, their protest resembles that of the original tea party. The eighteenth century civil disobedience in Boston was about lack of representation and tax dispensations for a select few. As historians have explained, the colonial ruffians who dumped tea into Boston Harbor “were objecting to a special tax exemption that Parliament had granted to the East India Company,”<sup>25</sup> a government-backed importer of, among other things, tea. From the perspective of the colonists, the Crown was treating them as second-class citizens, yet still expected them to act as loyal subjects and to remit taxes obediently.

As in 1773, so in 2010. Whether identified as Tea Party “patriots” or generally disaffected citizens, Americans continue to protest tax burdens disproportionate to government benefits. The feeling is that taxes, whether rising or falling, buy too little in the way of public goods, and subsidize undeserving recipients. It is not as if Americans are unwilling to “pay for civilized society,” to borrow Justice Oliver Wendell Holmes’ aphorism,<sup>26</sup> but they recoil

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<sup>22</sup> See Kate Zernike & Megan Thee-Brenan, “Poll Finds Tea Party Backers Wealthier and More Educated,” *The New York Times* (14 April 2010), online: <<http://www.nytimes.com>>.

<sup>23</sup> *Ibid.* For the complete poll results, see Stephanie Condon, “Poll: Who Are the Tea Partiers?,” *CBS News*, online: <<http://www.cbsnews.com>>.

<sup>24</sup> Joseph J Thorndike, “We Don’t Mind Taxes. We Hate Tax Loopholes,” *The Washington Post* (12 September 2010) B3 [Thorndike, “Loopholes”].

<sup>25</sup> *Ibid.*

<sup>26</sup> The full quote is “[t]axes are what we pay for civilized society”. See *Compania General de Tabacos de Filipinas v Collector of Internal Revenue*, 275 US 87 at 100, 48 S Ct 100 (1927), Holmes J, dissenting. See also Randolph E Paul, *Taxation for Prosperity* (Indian-

when other citizens attempt to purchase “civilization at a discount”.<sup>27</sup> Indeed, as Thorndike recently opined, “We’ve long agreed to pay the price for civilization. We just can’t tolerate anyone looking for civilization on the cheap”.<sup>28</sup>

Thus, Americans do necessarily not hate taxes. Instead, they hate what they get in return—or at least what they think they get in return. That includes not only overpriced, low-quality benefits of civilization, but also the unduly burdensome process of *paying* for those benefits. The awful, complex, anxiety-ridden process of remitting payment to the government in exchange for public goods that taxpayers alternatively vilify or demand. Nor is it true that Americans necessarily hate government. Rather, they hate government that commands rather than enables. Indeed, with particular respect to their federal government, Americans prefer inconspicuous to conspicuous, invisible to visible, or, as one historian of the American political tradition recently put it, Americans desire government that is “hidden in plain sight”.<sup>29</sup>

Mindful of Americans’ preference for efficient and unobtrusive government, this article makes several additional observations to assist in ameliorating the current perception that the burdens of citizenship outweigh the benefits.

First, the tax-filing interface that connects citizens with their government sets the tone for how citizens feel not only about the extraction of tax payments but also what those payments purchase. The current interface is

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apolis: Bobbs-Merrill, 1947) at 277 (quoting Holmes: “I like to pay taxes. With them I buy citizenship”).

<sup>27</sup> Joseph J Thorndike, “Civilization at a Discount: The Morality of Tax Avoidance”, *Tax Notes* 95:5 (29 April 2002) 664 (citing Henry Morgenthau Jr in 1937 during President Franklin Roosevelt’s crusade against tax loopholes as observing that “too many citizens want the civilization at a discount”).

<sup>28</sup> Thorndike, “Loopholes”, *supra* note 24.

<sup>29</sup> Brian Balogh, *A Government Out of Sight: The Mystery of National Authority in Nineteenth-Century America* (Cambridge: Cambridge University Press, 2009) at 380. See also Max M Edling, *A Revolution in Favor of Government: Origins of the U.S. Constitution and the Making of the American State* (New York: Oxford University Press, 2003), arguing that early political leaders of the American republic—even the Federalists, purportedly the party of “limited government”—coalesced around the need for a strong national state, particularly for state formation and state building.



grossly deficient. Preparing one's taxes is unduly complex, intimidating, and scary. The process produces confusion, anger, and anxiety. It oozes inefficiency, neglect, and impersonal bureaucracy. If the government is going to require taxpayers to pay for public goods—failure to file an annual tax return can result in a strict liability penalty up to twenty-five per cent of tax owed (and seventy-five per cent for fraudulently filed returns),<sup>30</sup> while wilful failure to file is punishable by up to one year in prison<sup>31</sup>—it has a responsibility to facilitate that process with efficiency, open lines of communication, and helpful customer service. Imagine encountering the same difficulty when purchasing a pair of shoes or a refrigerator or a car. Paying one's taxes might never be as easy (or as fun) as buying a new handbag, but it should not be as painful as currently conceived.

Second, requiring citizens to pay for public goods creates what an older generation of public finance economists called “tax consciousness”. “This may be a mere feeling of irritation”, one prominent study of US taxation noted in 1937, “or a genuine interest in improving the system”.<sup>32</sup> And in fact, taxation can produce “good” and “bad” forms of consciousness. Bad tax consciousness breeds resentment, anger, and anti-tax, anti-government sentiments. Currently, tax filing and tax administration in the United States fosters bad tax consciousness, and threatens the revenue integrity and long-term viability of the federal income tax. Good tax consciousness, on the other hand, provides an opportunity to educate, to raise awareness of the relationship between benefits and burdens, and, ultimately, to “improv[e] the system”. It involves considerably more than reminding taxpayers of their financial obligations to the state, however. An overly tax-sensitive citizenry exhibits bad rather than good tax consciousness. Striking a balance requires employing a judicious mix of tax bases (i.e., income, property, consumption) as well as situation-specific collection methods (i.e., withholding, third-party reporting, direct payment). It means employing visible as well as invisible

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<sup>30</sup> *Internal Revenue Code*, 26 USC § 6651 (2010).

<sup>31</sup> *Internal Revenue Code*, 26 USC § 7203 (2010).

<sup>32</sup> Carl Shoup, Roy Blough & Mabel Newcomer, *Facing the Tax Problem: A Survey of Taxation in the United States and a Program for the Future* (New York: Twentieth Century Fund, 1937) at 53.

forms of taxation, connecting the burdens to the benefits, and assisting taxpayers in filing their annual returns with enhanced technology, security, and customer service.

Finally, improving tax filing can do even more than foster good tax consciousness. While the filing process may appear a mundane subject of inquiry, it directly affects taxing capacity and functionality. A clunky, hard to use, scary regime collects less revenue in a less efficient manner, undermines revenue capacity, angers and frustrates citizens, generates mistrust of government, and fosters noncompliance. On the other hand, an efficient, easy to use interface builds trust and appreciation, promotes compliance, and achieves lower costs for taxpayers and tax officials, to say nothing of fewer challenges to return positions, less litigation, and increased revenue. At the same time, it offers an opportunity to communicate with taxpayers and their advisors, listen to their concerns, meet their needs, provide information, and improve the system. In addition to offering basic and helpful information, an interactive, responsive tax-filing regime could communicate, for example, how much tax revenue the government collects each year and from what sources; how the government spends the money it collects; how the US tax and revenue system compares with other countries; what taxpayers across income groups paid in federal, state, and local taxes; and how that burden has changed over time. In these and other ways, a reformed tax-filing regime could serve a communicative and educative function. It could turn the annual rite of tax-paying into a dialogue between citizens and their government, a civics lesson for taxpayers as well as tax officials, and an opportunity to improve the system year after year.

The balance of this article proceeds in three parts. Part I explores the concept of tax consciousness more fully, both from the perspective of its early proponents and how tax-filing reforms based on communication and information exchange between individual taxpayers and their government could invigorate a modern tax consciousness responsive to the needs of taxpayers, tax advisors, and tax regulators. Part II examines failed attempts to reform tax filing, and offers an entirely new recommendation that overcomes the shortcomings of earlier reform proposals by leveraging technology and the government's core competency for maximizing efficiencies in tax filing, and making it less costly, more consumer friendly, secure, and even gratifying. Finally, Part III illustrates how this new model of tax filing and its emphasis

on communication between taxpayers, tax professionals, and tax officials reflects the modern regulatory theory of responsive regulation and, as such, holds the promise of establishing ongoing and beneficial dialogue between taxpayer-citizens and their government.

## II. PROMOTING TAX CONSCIOUSNESS WITH A GOVERNMENT “HIDDEN IN PLAIN SIGHT”

Paying taxes is a kind of social theater, a civic ritual. The annual, shared rite of filing one’s taxes binds people, community, and society, much like voting, and it reflects and reinforces one’s citizenship responsibilities. Indeed, a former Commissioner of Internal Revenue recently drew explicit comparisons between paying taxes and voting, calling them each “a unifying experience fundamental to our democracy and respect for the rule of law.”<sup>33</sup>

Currently, the civic value of taxpaying in the United States does not live up to its lofty potential. The process of paying one’s taxes serves to make citizens angry, frustrated, and anxious. It also generates feelings of animosity toward the government that are readily transformed into anti-tax, anti-statist sentiment under the right conditions (such as, for instance, a severe economic downturn accompanied by high rates of unemployment, tight credit, bankrupt public services, declining infrastructure, and a shrinking safety net).

But the “filing ceremony”, as tax scholar Lawrence Zelenak has called it, can also increase civic-mindedness, nurture positive feelings about the state, reinforce financial and fiscal citizenship, and educate taxpayers not just about the cost of government but also what all those tax payments purchase.<sup>34</sup> In this way, tax filing can promote tax consciousness, which its early proponents considered “a force for good government”.<sup>35</sup>

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<sup>33</sup> US, President’s Advisory Panel on Federal Tax Reform (3 March 2005) at 2 (testimony of Mark W Everson). See also Lawrence Zelenak, “Justice Holmes, Ralph Kramden, and the Civic Virtues of a Tax Return Filing Requirement” (2007) 61:1 Tax L Rev 53 for a wonderful discussion of taxpaying as civic ritual.

<sup>34</sup> *Ibid* at 60.

<sup>35</sup> Shoup, Blough & Newcomer, *supra* note 32 at 421.

Citizens can gain consciousness about taxation in a variety of ways. The “most important” source of tax consciousness, according to an earlier generation of tax scholars, involved “the number of people who pay taxes and the amount that they pay directly to the government”.<sup>36</sup> The second category—preserving the link between taxpayer and government—will be discussed below. But the first category—number of citizens paying taxes—includes taxpayers at the national as well as sub-national levels remitting federal income taxes, state and local property taxes, automobile and gasoline taxes, “sin” taxes on cigarettes and liquor, and retail sales taxes. Awareness of multiple taxes and taxing jurisdictions heightened tax consciousness, which earlier commentators viewed as a good thing.<sup>37</sup> But it could also turn citizens against the taxing power of the state.

Indeed, government officials must be careful not to make citizens too aware of tax burdens, particularly when those burdens are not sufficiently linked to benefits. Unpopular taxes or layered taxes on multiple bases can raise tax consciousness to such a pitch that taxpayers feel besieged on all sides, a debtor to government at every level. At that point, consciousness morphs into resentment, anti-tax resistance, and rebellion.<sup>38</sup> A tax may achieve “such a stage of unpopularity that a large proportion of the taxpayers evade it successfully”.<sup>39</sup> Tax consciousness of this sort “is scarcely considered desirable” both for its adverse effects on revenue and because “the evasion becomes so habitual and so complete that practically all consciousness of the

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<sup>36</sup> *Ibid* at 352.

<sup>37</sup> *Ibid* at 354 (noting that multiple levels of tax “intensified . . . the tax consciousness of a considerable number” of taxpayers).

<sup>38</sup> Such “anti-tax consciousness” generated several tax revolts in the twentieth century, including the resistance of the 1930s (see Beito, *supra* note 3), 1970s, and 1980s (see Martin, *supra* note 3; O’Sullivan et al, *supra* note 3). Earlier tax consciousness scholars noted the debilitating effects of too much tax consciousness: see Shoup, Blough & Newcomer, *supra* note 32 at 363–64 (discussing tax revolts of the 1930s: “Well-organized publicity by private groups has at times created passing waves of tax consciousness. In some states . . . the organized movement has aroused the taxpayer to such a pitch that drastic tax limits have been put in the constitution”).

<sup>39</sup> Shoup, Blough & Newcomer, *supra* note 32 at 362.

tax is lost”.<sup>40</sup> To the extent that other taxpayers are aware of the evasion but unable to shift or avoid their own burdens, resentment grows still further. Ineffective or heavy-handed tax administration or inexpert officials can also transform consciousness into resentment and rebellion.<sup>41</sup> So, too, with compliance costs. While early tax consciousness scholars rightly noted that compliance requirements could foster “an important stimulant of tax consciousness”,<sup>42</sup> overly burdensome requirements also breed resentment, and reduce compliance rather than raising it.

More than anything, to be effective as a force maximizing civic value, tax consciousness must link the burdens and benefits of taxpaying. It must “show the taxpayer a connection between amount of expenditures and amount of tax”,<sup>43</sup> between the price of civilization and the goods it produces. For this reason, early commentary on the virtues of tax consciousness strongly criticized retail sales taxes in states that amalgamated distinct tax prices into final purchase prices. Failure to disaggregate the costs not only prevented the consumer-taxpayer from realizing that some percentage of the purchase price was remitted to the government but also that the tax raised the item’s overall price.<sup>44</sup> Linking the burdens and benefits of taxes also involves making the taxpayer “aware of the different levels of government”, so that the taxpayer, for example, neither attributes the burden of the property tax to the federal government nor fails to attribute the benefits of improved schooling to the state or municipality.<sup>45</sup> Similarly, it was critical to make the connection between fluctuating tax liability to “variations in the volume of governmental expenditures”.<sup>46</sup>

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<sup>40</sup> *Ibid* at 362–63.

<sup>41</sup> *Ibid* at 362 (“Administration of a tax in an officious and generally tactless manner is another way to heighten consciousness into resentment”). See also Dennis J Ventry Jr, “Cooperative Tax Regulation” (2008) 41:2 Conn L Rev 431 for a modern discussion of the relationship between taxpayers and tax regulators.

<sup>42</sup> Shoup, Blough & Newcomer, *supra* note 32 at 364.

<sup>43</sup> *Ibid* at 421.

<sup>44</sup> *Ibid* at 360, 422.

<sup>45</sup> *Ibid* at 421.

<sup>46</sup> *Ibid* at 363.

Perhaps the most important burden/benefit relationship, according to tax consciousness proponents, involved the payment of taxes. "When a person pays a tax as a separate transaction between himself and the government, he is far more aware of it than when he pays it as a hidden charge".<sup>47</sup> Indeed, this concern about the effects of remittance on tax consciousness informed these scholars' views of the retail sales tax and their opposition to burying its value in the full retail price. It also informed their wariness of old-age pensions under the nascent Social Security program,<sup>48</sup> which instituted withholding at the source on a mass scale for the first time in the United States: "It will be of interest", they wrote, "to discover whether a long-continued payroll deduction results in the employees' finally forgetting that the cause of the deduction is a tax. Perhaps the form in which they are notified of the deduction will prevent a loss of tax consciousness."<sup>49</sup> Automatic third-party collection and remittance broke the link between burden and benefit, weakened tax consciousness, and created inert, apathetic taxpayers.<sup>50</sup> "Moving to a wholly depersonalized system", warned economist Richard Musgrave, himself a long-time proponent of vibrant tax consciousness, "would reduce taxpayer awareness of the fiscal process and thereby dilute responsible fiscal citizenship."<sup>51</sup>

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<sup>47</sup> *Ibid* at 352.

<sup>48</sup> *Ibid* at 359.

<sup>49</sup> *Ibid* at 361–62; US, *President's Advisory Panel on Tax Reform* (2005). Despite the withholding regime for payroll taxes, Americans remain acutely aware of their burden. See *infra* note 105. More generally, however, cognitive theorists have found that indirect versus direct tax remittance results in a loss of tax consciousness, and helps explain the relative enthusiasm among policymakers for relying on tax collection that escapes notice, such as withholding on wages and income. See Edward J McCaffery, "Cognitive Theory and Tax" (1994) 41:7 *UCLA L Rev* 1861 at 1874–86. In fact, some tax experts have argued for indirect taxes precisely because they obscure the burden. See Thomas F Field, "The Emperor Has No Clothes", *Tax Notes* 101:9 (1 December 2003) (arguing to replace visible taxes such as the income tax with less visible taxes such as sales and consumption taxes as a way to overcome knee-jerk reactions to taxes in the modern political context).

<sup>50</sup> Recently, conservatives have identified withholding as public enemy number one in their anti-tax, limited-government campaign: see e.g. Shlaes, *supra* note 4 at 8. See also *infra* notes 108–110 and accompanying text.

<sup>51</sup> Richard A Musgrave, "Clarifying Tax Reform", *Tax Notes* 70:6 (5 February 1996) 731 at 732.

Thorndike makes Musgrave's point more sharply: "[t]axes should be uncomfortable", he says. "Not especially painful, mind you—just a bit irritating. Enough to make you pay attention. Modest discomfort is an element of citizenship, reminding voters of the price they pay (thank you, Justice Holmes) for civilized society".<sup>52</sup>

Striking a balance between making taxpaying too easy and too hard—both of which undermine tax consciousness—is no easy task. It is made harder still by priorities other than concerns over fiscal citizenship. Hidden versus obvious taxes, painful versus pain-free filing, and direct versus indirect tax payments influence not just levels of tax consciousness, but also compliance, administration, and cost. Sources of income subject to both withholding—which policymakers adopted for the federal income tax in the 1940s<sup>53</sup>—and third-party reporting boast compliance rates close to one hundred per cent, while less than half of all sole proprietorship income, which is not subject to withholding or third-party reporting, gets reported accurately.<sup>54</sup> Moreover, innovative tax-filing regimes (including pre-filled tax returns, such as California's ReadyReturn, and data retrieval systems that allow taxpayers and their preparers to access an inventory of tax account information) can ease the filing burden, reduce costs for taxpayers and tax administrators, and result in more timely and accurate tax payments.<sup>55</sup> These administrative efficiencies no doubt reduce tax consciousness to some extent.<sup>56</sup> But as discussed in Parts II and III, they offer considerably more in the way of

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<sup>52</sup> Joseph J Thorndike, "The Number One Tax Reform", *Tax Notes* 115:3 (16 April 2007) 257 at 257.

<sup>53</sup> See Dennis J Ventry Jr & Joseph J Thorndike, "The Plan That Slogans Built: The Revenue Act of 1943", *Tax Notes* 76:9 (1 September 1997) 1241.

<sup>54</sup> See Internal Revenue Service (IRS), News Release, IR-2006-28, "IRS Updates Tax Gap Estimates" (14 February 2006) at "Tax Gap Figures" slides 2–3, online: <<http://www.irs.gov>> (based on 2001 data—the most recent available—less than one per cent of all wage, salary, and tip income is underreported, while an astounding fifty-seven per cent of sole proprietor income is misreported). See also Tax Policy Center, *The Tax Gap: What is the tax gap?*, online: <<http://www.taxpolicycenter.org>>; *Tax Gap Figures*.

<sup>55</sup> These alternatives are discussed in greater detail in Part II of this article.

<sup>56</sup> See Joseph J Thorndike, "What You Don't Know Can Hurt You", *Tax Notes* 107:4 (25 April 2005) 429 at 430.

reinforcing the integrity of the revenue system, reducing undue burdens and anxieties for taxpayers, and opening lines of communication between taxpayers, tax preparers, and tax regulators.

Efficiencies in the tax system also complement Americans' preference for a government out of sight. Contrary to conservative mythology, Americans expect quite a bit from their government. In fact, according to historian Brian Balogh, from the very beginning of the republic, Americans asked their government to do a lot for them.<sup>57</sup> As Balogh explains, a strong national government "touched virtually every American life,"<sup>58</sup> and belies conservative claims that anti-statism animates the American character. While it is true that Americans generally resisted a national bureaucratic state, they responded favorably to an activist government that was "inconspicuous, or at least hidden in plain sight."<sup>59</sup>

The paradox finds no greater expression than in US tax policy. The federal tax expenditure budget contains more than \$1 trillion worth of government spending.<sup>60</sup> Individual tax expenditure items operate like entitlement programs on the spending side of the budget. They are subject to neither annual appropriations nor congressional vote. And they grow more expensive with each passing year as the economy expands and as Congress shifts policymaking responsibility from the direct expenditure budget to the tax expenditure budget.<sup>61</sup> Indeed, this "hidden welfare state"<sup>62</sup> includes some of the most cherished and sacred government programs (including deductions for mortgage interest and charitable contributions), and it has assumed primary

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<sup>57</sup> Balogh, *supra* note 29 at 3 ("Where no immediate institutions stood between citizen and national government, Americans consistently advocated energetic governance when it came to trade, security, and economic development").

<sup>58</sup> *Ibid* at 11.

<sup>59</sup> *Ibid* at 380.

<sup>60</sup> US, Office of Management and Budget, *Analytical Perspectives: Budget of the U.S. Government: Fiscal Year 2011* (2010) at 207–43. See also Donald B Marron, "How Large Are Tax Expenditures?", *Tax Notes* 130:13 (28 March 2011) 1597.

<sup>61</sup> See *infra* notes 84–86 and accompanying text.

<sup>62</sup> Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton: Princeton University Press, 1999).



responsibility for many core government functions, such as promoting homeownership, providing healthcare, enabling retirement security, and funding education.

Hidden tax subsidies can be as detrimental to tax consciousness as hidden taxes. Both victimize and reinforce an unwary, passive citizenry. And both reflect opaque rather than transparent government. Moreover, with respect to hidden tax subsidies, even popular items such as the mortgage interest deduction may dull consciousness as citizens come to assume that they distribute benefits equitably, efficiently, and effectively, that they accomplish what they set out to achieve, and that they continue to reflect national priorities.<sup>63</sup> It may not be a good idea, particularly during fiscal crises, to rely on mandatory spending programs that grow exponentially in size and cost, and that avoid meaningful re-examination after enactment.

As we consider improvements or replacements to the tax-filing regime, we should be mindful of the tradeoffs between hidden versus obvious taxes and painful versus painless filing, particularly in light of the expressed preference of Americans for a government that governs actively but unobtrusively.

### III. IMPROVING TAX FILING WITH A DATA RETRIEVAL SYSTEM

The fundamental premise of this article understands that Americans do not hate taxes but rather paying taxes, and for good reason. Taxpaying in the United States is as uncomfortable, difficult, and expensive as possible, particularly with respect to remitting federal income taxes. The IRS estimates that individual income tax filers spend nearly twenty hours each year maintaining tax records, planning return positions, and preparing and filing returns.<sup>64</sup> In fact, roughly 140 million individual tax filers log more than 2.5

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<sup>63</sup> See Dennis J Ventry Jr, "The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest" (2010) 73:1 Law & Contemp Probs 233 [Ventry, "Accidental"] for a discussion of these issues in the context of the mortgage interest deduction. For the inequitable distribution of tax expenditures, see *infra* note 177 and accompanying text.

<sup>64</sup> US, President's Economic Recovery and Advisory Board (PERAB), *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation* (August 2010) at 41.

billion hours each year in fulfilling their taxpaying obligations.<sup>65</sup> At a conservative wage rate of \$25 per hour, that adds up to \$87.5 billion, and it still excludes the psychic costs of frustration, anxiety, and worry experienced by every taxpayer.<sup>66</sup> When added to the \$32 billion expended annually for accountants, lawyers, paid preparers, and tax preparation software, the final bill tallies an astounding \$120 billion.<sup>67</sup> All told, compliance costs under the US individual income tax exceed ten per cent of revenue collected,<sup>68</sup> considerably more than the cost of administration in some European countries, including Sweden and Denmark which spend only one per cent of taxes collected to administer their tax systems.<sup>69</sup>

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<sup>65</sup> *Ibid.*

<sup>66</sup> Author's calculation. For a discussion of the difficulty in monetizing the psychic costs of taxpaying, see John L. Guyton et al., "Estimating the Compliance Costs of the U.S. Individual Income Tax" (2003) 56:3 Nat'l Tax J 673.

<sup>67</sup> The \$32 billion figure is from PERAB, *supra* note 64. Notably, it excludes the additional cost of administering the individual income tax for the government (both for the IRS and the Social Security Administration, the latter of which receives and processes wage and income data for taxpayers before forwarding the information to the IRS) as well as for employers and third-party payers that collect, remit, and report the vast majority of all federal income tax liabilities. It also excludes post-filing costs for taxpayers associated with responding to IRS inquiries and deficiency notices, complying with investigations, taking advantage of dispute resolution procedures, and, when all else fails, litigating return positions.

<sup>68</sup> The calculation involves dividing total compliance costs for individual taxpayers (\$120 billion) by total gross collections (\$1.175 billion). For gross collections see IRS, *Tax Stats at a Glance* (August 2010), online: <<http://www.irs.gov>>. See also Joel B. Slemrod, *Testimony Submitted to the Committee on Ways and Means, Subcommittee on Oversight, Hearing on Tax Simplification* (15 June 2004) (estimating collection costs of total individual income tax receipts at more than ten per cent of revenue).

<sup>69</sup> US, Department of the Treasury, *Report to the Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite* (December 2003) at 12 (reporting compliance costs in Sweden at one per cent of revenue), online: <<http://www.treasury.gov>>.

### A. EARLIER EFFORTS TO REFORM TAX FILING: EXACT WITHHOLDING AND TAX AGENCY RECONCILIATION

For the last twenty-five years, tax policymakers and officials have sought ways to reduce filing costs and “to make income tax compliance less burdensome”.<sup>70</sup> In 1986, as part of that year’s seminal Tax Reform Act,<sup>71</sup> Congress instructed the Treasury Department to report on the feasibility of moving to a “no-return” system for the federal income tax. The Treasury complied by releasing a detailed report the following year.<sup>72</sup> Other government agencies undertook their own studies on mitigating the filing burden,<sup>73</sup> while tax researchers made the subject an area of scholarly and expert inquiry.<sup>74</sup> In 1998,

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<sup>70</sup> US, Department of the Treasury, Press Release, *Treasury Deputy Assistant Secretary for Tax Analysis Leonard E Burman Testimony before the Senate Appropriations Subcommittee on Treasury and General Government* (LS-548) (13 April 2000), online: <<http://www.treasury.gov>>.

<sup>71</sup> *Tax Reform Act of 1986*, Pub L No 99-514, 100 Stat 2085 (reflecting efforts of several generations of tax reformers to reduce tax rates in conjunction with broadening the base by plugging loopholes, an achievement that reformers long regarded as an “impossible dream”). See also George F Break & Joseph A Pechman, *Federal Tax Reform: The Impossible Dream?* (Washington, DC: Brookings Institution, 1975).

<sup>72</sup> US, Department of the Treasury, IRS, *Current Feasibility of a Return-Free System* (Washington, DC: 1987) cited in Department of the Treasury, *supra* note 69 at 15 n 20.

<sup>73</sup> See e.g. US, Government Accountability Office (GAO), *Tax Administration: Alternative Filing Systems* (GAO/GGD-97-6) (Washington, DC: 1996) [GAO, *Alternative*]; US, GAO, *Tax System: Issues in Tax Compliance Burden*, Testimony before the Subcommittee on National Economic Growth, Natural Resources and Regulatory Affairs, Committee on Government Reform and Oversight, House of Representatives (GAO/T-GGD-96-100) (Washington, DC: 1996), online: <[www.gao.gov](http://www.gao.gov)>; US, GAO, *Status of Tax Systems Modernization, Tax Delinquencies, and the Potential for Return-Free Filing*, Testimony before the Subcommittee on Treasury, Postal Service and General Government, Committee on Appropriations, House of Representatives (GAO/T-GGD/AIMD-96-88) (Washington, DC: 1996), online: <<http://www.gao.gov>>.

<sup>74</sup> See e.g. Janet Holtzblatt, *Implications of Return-Free Tax Systems for the Structure of the Individual Income Tax* (June 2006), online: Georgia State University <<http://aysps.gsu.edu>> [Holtzblatt, *Implications*]; Austan Goolsbee, *The Simple Return: Reducing America’s Tax Burden Through Return-Free Filing*, Discussion Paper 2006-04 (July 2006), online: The Brookings Institution <<http://www.brookings.edu>>; Joseph A Bankman,

Congress reaffirmed its commitment to lessening the filing burden by ordering the Treasury Department to develop procedures for implementing a return-free regime by 2007 for "appropriate" persons, and to report periodically on its progress.<sup>75</sup> Individual state governments followed the lead of the federal government, and began experimenting with return-free systems in the 1990s and 2000s.<sup>76</sup> To date, however, only California offers state income tax payers such a service through its free, online program, ReadyReturn.<sup>77</sup>

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"Simple Filing for Average Citizens: The California ReadyReturn", *Tax Notes* 7:11 (13 June 2005) 1431; William G Gale & Janet Holtzblatt, "On the Possibility of a No-Return Tax System" (1997) 50:3 Nat'l Tax J 475.

<sup>75</sup> *Internal Revenue Service Restructuring and Reform Act of 1998*, Pub L No 105-206, § 2004, 112 Stat 685. See also US, Senate Committee on Finance, 105th Cong, *Internal Revenue Service Restructuring and Reform Act of 1998* (S Rep No 105-174) (Washington, DC: 1998) at 42. For the most detailed of Treasury's subsequent reports, see Department of the Treasury, *supra* note 69.

<sup>76</sup> In 2004, California launched "ReadyReturn," a program offering low- and middle-income taxpayers a pre-filled tax return using wage and income data already in the state's possession supplied by taxpayers and their employers. The pre-filled return offered taxpayers a service similar to the tax-agency reconciliation systems discussed at *infra* notes 79-81 and accompanying text. User satisfaction was overwhelming with ninety-eight to ninety-nine per cent of users reporting that they were either "Very Satisfied" or "Satisfied" with ReadyReturn. Franchise Tax Board, *ReadyReturn Pilot: Tax Year 2004 Study Results* (2006) at 1. In the late 1990s, Colorado, Michigan, and Louisiana attempted to implement a no-return option for resident taxpayers. For various reasons, the experiments were short-lived. See Holtzblatt, *Implications, supra* note 74 at 8-12 (referring to systems in Michigan, Louisiana, Colorado, and California); Department of the Treasury, *supra* note 69 at 10-11.

<sup>77</sup> California's ReadyReturn offers free service to two million resident taxpayers with relatively simple returns. For a full description of the ReadyReturn program, see State of California Franchise Tax Board, *ReadyReturn: Your California Tax Return May Be Ready and Waiting for You*, online: <<http://www.ftb.ca.gov>>. The program has its detractors, chief among them Intuit Corporation, which views ReadyReturn as competition to its industry-leading tax preparation software, TurboTax. For Intuit's long-running effort to stymie ReadyReturn, see Dennis J Ventry Jr., "Intuit's Nine Lies Kill State E-Filing Programs and Keep 'Free' File Alive", *State Tax Notes* 555:57 (2010); Dennis J Ventry Jr., "Intuit Just Won't Quit", *Los Angeles Times* (21 July 2010) A17; David Brunori, "Don't Let Intuit Kill ReadyReturn", *State Tax Notes* 429:54 (2009); Dennis J Ventry Jr., "Intuit Uses Clout to Stymie State Innovation", *Sacramento Bee* (6 October 2009) 11A; Anthony York, "Turbo

Two primary means of reducing compliance burdens for individual taxpayers have dominated the discussion: exact withholding and tax agency reconciliation. Exact withholding variants come in two forms. Under a “cumulative” withholding system (used in Britain and Russia), taxpayers provide information to employers or tax officials (name, address, filing status, Social Security number, names of any children or spouses) that allow the employer or tax agency to calculate and withhold the correct amount of tax from each paycheck throughout the year.<sup>78</sup> Taxpayers verify and update this information on a regular basis, and alert employers or tax officials in the event of changed circumstances, such as filing status or number of children. Under a “final” withholding system (used in Germany and Japan), taxpayers provide basic information at the beginning of the tax year to assist in calibrating withholding but do not typically update the information throughout the year. Instead, employers or tax officials adjust the employee’s final paycheck of the year to reconcile outstanding tax liability (or to issue a refund). Tax agency reconciliation systems (used in Denmark, Sweden, Spain, and California) also rely on basic information provided by the taxpayer in addition to information returns by employers, financial institutions, and other third parties. The key difference is that the tax authority itself uses the withholding and reporting information to calculate a taxpayer’s liability and to subsequently send the taxpayer a pre-filled tax return to review (and perhaps dispute), which reflects tax owed or amount to be returned. Thereafter, the tax agency either forwards a bill or issues a refund.<sup>79</sup> According to estimates, adopting either

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Tax Maker Intuit, Again, Is Mired in Political Turmoil”, *Capitol Weekly* (24 September 2009) A1; Shane Goldmacher & Patrick McGreevy, “California GOP Legislators Blocked 20 Bills After Demands Were Unmet”, *Los Angeles Times* (15 September 2009) A6; George Skelton, “GOP’s ‘Leverage’ Is Tantamount to Extortion”, *Los Angeles Times* (17 September 2009) A2; Evan Halper & Shane Goldmacher, “State Budget Negotiations Were Anything But Smooth”, *Los Angeles Times* (26 July 2009); Evan Halper, “Defying Legislators, Officials Revive Tax Return Program”, *Los Angeles Times* (5 December 2006) B1.

<sup>78</sup> See William J Turnier, “PAYE as an Alternative to an Alternative Tax System” (2003) 23:1 *Va Tax Rev* 205 (for a thorough discussion of the British filing system).

<sup>79</sup> For a good discussion of these “no-return” filing systems, see Tax Policy Center, *Ways to Improve the Tax System: Return-Free Filing*, online: <<http://www.taxpolicycenter.org>>;

exact withholding or tax agency reconciliation (or some combination of the two) could liberate as many as fifty-four per cent of current US taxpayers from the annual burden of filing a tax return.<sup>80</sup> The reforms could also cut administrative costs in terms of fewer returns to process and reduced expenditures for compliance efforts, enforcement, and litigation.<sup>81</sup>

Yet simplified filing remains elusive in the United States, notwithstanding its potential benefits for taxpayers and tax administrators. Hindsight helps explain the failure of the reform efforts over the last twenty-five years, particularly at the federal level: exact withholding and tax agency reconciliation proposals were (i) the wrong plans, (ii) at the wrong time, (iii) for the wrong tax system. We will examine each obstacle in turn, working backwards.

## 1. THE WRONG TAX SYSTEM

Exact withholding and tax agency reconciliation only work (if they work at all) in countries with considerably simpler tax systems than the United States.<sup>82</sup> In particular, the ideal setting includes, among other things: a unit of taxation based on the individual rather than the family; few and flat statutory rates; withholding or exempting of income from capital; withholding interest and dividend income at a flat, low rate; restricting deductions and limiting their value to a low, flat rate; restricting or eliminating credits; and

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Holtzblatt, *Implications*, *supra* note 74 at 3–12; Department of the Treasury, *supra* note 69 at 7–13; GAO, *Alternative*, *supra* note 73 at 8–11.

<sup>80</sup> See Goolsbee, *supra* note 74 at 5 (60 million taxpayers or 40 per cent of filers under tax agency reconciliation); Holtzblatt, *Implications*, *supra* note 74 at 17 (50 million taxpayers or 36 per cent of filers under tax agency reconciliation); Burman, *supra* note 70 at 6 (57 million taxpayers or 44 per cent of filers under hybrid plan); Gale & Holtzblatt, *supra* note 74 at 483 (63 million taxpayers or 54 per cent of filers under hybrid); GAO, *Alternative*, *supra* note 73 at 2 (51 million taxpayers or 45 per cent of filers under tax agency reconciliation); Department of the Treasury, *supra* note 69 (55 million taxpayers or 54 per cent of filers under hybrid).

<sup>81</sup> Holtzblatt, *Implications*, *supra* note 74 at 2; Department of the Treasury, *supra* note 69 at 35.

<sup>82</sup> *Ibid* at 2, concluding that “a return-free system is easier to operate the simpler the tax system”.

generally channeling transfers through direct subsidies rather than tax subsidies. Currently, the US tax system meets none of these conditions: the fundamental unit of taxation in the United States is the family; there are six statutory rates with relatively narrow brackets ranging from ten to thirty-five per cent; there is no withholding on capital gain income and the only exemption for such income applies to gains on the sale of a primary residence; withholding on interest and dividend income is severely limited and, in any event, subject to the full range of statutory rates; and taxpayers enjoy full deductibility of myriad deductions, a proliferation of haphazardly designed tax credits (which phase out at varying income levels), and a tax expenditure budget with over 175 individual items costing more than \$1 trillion.<sup>83</sup>

## 2. THE WRONG TIME

Attempting to simplify the US tax system at any point over the last twenty-five years for any reason, including facilitating adoption of a no-return filing regime, would have run counter to policymakers' and politicians' insatiable appetite for transferring more rather than less fiscal and social responsibilities to the tax system. Over the last twenty years, legislators across the political spectrum fell in love with spending through the tax code, such that between 1990 and 2007 tax expenditures (i.e. exclusions, deductions, exemptions, and credits) as a percentage of GDP jumped from 5.3 per cent to 7.5 per cent,<sup>84</sup> while tax expenditures as a percentage of total government expenditures rose from 21.5 per cent to 26.9 per cent over a similar period.<sup>85</sup> In other words, no meaningful opportunity for fundamental tax reform existed that might have led to substantive reforms to tax filing. While fundamental tax reform has

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<sup>83</sup> See Office of Management and Budget, *supra* note 60.

<sup>84</sup> Thomas L Hungerford, "Tax Expenditures and Long-Term Federal Budget Pressures", *Tax Notes* 121:12 (22 December 2008) 1409 at 1412.

<sup>85</sup> *Ibid* at 1413. For more on the growth of tax expenditure items during the 1990s and 2000s, see Martin A Sullivan, "Tax Incentives and Economists" *Tax Notes* 11:1 (3 April 2006) 20; Martin A Sullivan, "Hundreds of Tax Credits Sought by the 106th Congress", *Tax Notes* 89:12 (18 December 2000) 1536; Martin A Sullivan, "Tax Expenditure Budget, Now More Than Ever", *Tax Notes* (2000).

historically meant closing loopholes to pay for rate reduction,<sup>86</sup> Congress uncorked dozens of new loopholes in the 1990s and 2000s, and, on balance, raised statutory tax rates.

In addition to the unreceptive policymaking climate, significant uncertainty existed as to the cost of transitioning to an entirely new tax-filing regime. Though taxpayers would experience some savings with respect to compliance (including cost reduction for documenting, preparing, and submitting returns), they could face new costs such as preparing and submitting onerous new forms designed to make withholding more precise or to assist tax officials in reconciling tax liability,<sup>87</sup> updating those forms throughout the year to reflect changes in personal or financial circumstances,<sup>88</sup> and, under a tax agency reconciliation system, waiting longer to receive refunds while tax officials processed wage and income data trickling in from employers and third parties in order to populate and then send out completed returns.<sup>89</sup> In addition, commentators pointed out that the group of taxpayers that might be exempted under a no-return system already filed simple returns. In fact, according to one estimate, of the 50 million filers with relatively unsophisticated returns who might be served under a simplified sys-

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<sup>86</sup> See Dennis J Ventry Jr, "Equity versus Efficiency and the U.S. Tax System in Historical Perspective" in Joseph J Thorndike & Dennis J Ventry Jr, eds, *Tax Justice: The Ongoing Debate* (Washington, DC: The Urban Institute, 2000) 25 at 34–62.

<sup>87</sup> Holtzblatt, *Implications*, *supra* note 74 at 21; Robert A Boisture, Albert G Lauber & Holly O Paz, *Policy Analysis of "Return-Free" Tax System* (April 2006) at 21–22, online: Computer & Communications Industry Association <[www.ccianet.org](http://www.ccianet.org)>; Department of the Treasury, *supra* note 69 at 34; GAO, *Alternative*, *supra* note 73 at 12.

<sup>88</sup> *Ibid.*

<sup>89</sup> Holtzblatt, *supra* note 74 at 21–22; Boisture, Lauber & Paz, *supra* note 87 at 19; Department of the Treasury, *supra* note 74 at 37–38; GAO, *Alternative*, *supra* note 73 at 15. Indeed, the federal government does not require employers or third-party payers to file information returns (such as Forms W-2 and 1099) reflecting taxpayer wage and income data until the end of February, or two months into the filing season and just six weeks before the April 15 filing deadline. To make matters worse from the perspective of instituting a workable tax agency reconciliation system, it subsequently takes the IRS and Social Security Administration an additional seven months to verify and edit the 1.5 billion information returns that it receives. For a more detailed discussion of these timing and processing complexities, see *infra* note 98 and accompanying text.



tem, 85 per cent already used the stripped-down tax forms 1040A and 1040EZ.<sup>90</sup> For the remaining 100 million taxpayers with more complicated returns, only nine per cent would be exempted from a filing requirement.<sup>91</sup> And, finally, no-return systems as conceived in the 1990s and 2000s failed to eliminate the most burdensome tasks for taxpayers, such as recordkeeping, gathering materials, and tax planning.<sup>92</sup>

Employers, financial institutions, and other third parties also faced uncertain compliance costs under a reformed filing regime.<sup>93</sup> These entities already shouldered significant tax-collecting responsibilities by withholding taxes on various forms of income, compiling information reports (primarily on Forms W-2, 1099, 1098, and 5498),<sup>94</sup> and forwarding the reports to individual taxpayers and the government. This tax-collecting responsibility would grow under either exact withholding or tax agency reconciliation. In particular, third parties would be required to accelerate the reporting of wage and income data, perhaps as early as January 31, two months earlier than under the existing regime. In addition, shifting to an e-filing system would entail additional costs for some third-party payers who still submit information reports by paper rather than electronically. Also, third parties would likely be required to collect new kinds of information from taxpayers, such as changes in family status, dependents, charitable contributions, and unreimbursed medical expenses. This task would raise costs still further, and might be met with resistance from taxpayers reluctant to share such information with employers. Finally, all of the reformed tax-filing proposals would expand withholding to more sources of income, not just wage income. Such efforts in the recent past, however, indicate that renewed attempts to expand withholding

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<sup>90</sup> Holtzblatt, *supra* note 74 at 19; Boisture, Lauber & Paz, *supra* note 87 at 22.

<sup>91</sup> Holtzblatt, *supra* note 74 at 19.

<sup>92</sup> Eric J Toder, *Return-Free Tax Systems and Taxpayer Compliance Costs*, Presentation to the President's Advisory Panel on Federal Tax Reform (May 2005) at Slide 7.

<sup>93</sup> Holtzblatt, *supra* note 70 at 22–23; Boisture, Lauber & Paz, *supra* note 87 at 20–21; Department of the Treasury, *supra* note 69 at 35, 38–39.

<sup>94</sup> For the sources of income reflected on these forms, see *infra* notes 141–157 and accompanying text.

would be met with substantial resistance from taxpayers and the business community.<sup>95</sup>

The potential costs associated with administering a no-return filing system raised the biggest uncertainties.<sup>96</sup> Estimates varied wildly. The IRS predicted that a no-return system would cost \$175 million annually (\$345 million in 2011 dollars), while the Government Accountability Office estimated annual savings of \$37 million (\$53 million in 2011 dollars).<sup>97</sup>

There was less debate that administrative responsibilities would increase under a no-return system. Tax officials would have to perform two unrelated administrative tasks at the same time: processing traditional returns for taxpayers ineligible for a no-return system, and processing and matching information returns for eligible participants. This division of labour would require the IRS to hire and train new employees, reallocate resources, purchase equipment, and lease or build facilities to house the new personnel and infrastructure. In addition, the IRS would have to process, edit, and match more than one billion information returns during the normal filing season (i.e., before April 15), nearly six months faster than its usual processes.<sup>98</sup> And in

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<sup>95</sup> In 1982, Congress extended withholding requirements to additional sources of income through a ten per cent withholding tax on interest and dividends: *Tax Equity and Fiscal Responsibility Act of 1982*, Pub L No 97-248, §§ 201–08, 96 Stat 32. Opposition to the new requirement from banks, financial institutions, and other third parties was so fierce that Congress repealed it almost immediately: *Interest and Dividend Tax Compliance Act of 1983*, Pub L No 98-67, § 102, 97 Stat 369 (1983). Similarly, in 1987, and as mandated by the *Tax Reform Act of 1986*, the IRS introduced a new and considerably longer Form W-4 for taxpayers to fill out to achieve more accurate withholding. Due to widespread criticism that the form was “complicated and burdensome,” the agency withdrew it within a year”: Burman, *supra* note 70.

<sup>96</sup> See generally Holtzblatt, *supra* note 74 at 24–25; Boisture, Lauber & Paz, *supra* note 87 at 15–20; Department of the Treasury, *supra* note 74 at 35–36, 39. GAO, *Alternative*, *supra* note 73 at 15.

<sup>97</sup> IRS, *supra* note 72 at 3; GAO, *Alternative*, *supra* note 73 at 14.

<sup>98</sup> Holtzblatt, *supra* note 74 at 21, n 26 (it takes the IRS until the beginning of October to receive, validate, edit, and process all wage and income data received by employers and other third parties for the current filing season). In 2006, less than one per cent of Forms W-2 were posted to the IRS masterfile by April (this figure accelerated to eighty-eight per cent by the end of July and ninety-nine per cent by the end of September), while only

fact, under a no-return system, it would probably have to compress nine months of work into something more like two months to provide enough time for computing tax liabilities, generating pre-filled tax returns, and forwarding returns to eligible taxpayers early enough to review, verify, and perhaps dispute before the April 15 deadline. The government-generated returns would also have to arrive early enough for those taxpayers residing in the thirty-five states that require their residents to rely on federally adjusted gross income, taxable income, or tax liability when calculating state income taxes.<sup>99</sup> And although electronic filing and communication promised to alleviate some of the obstacles to a no-return system, the technological revolution was just underway at the IRS.<sup>100</sup>

### 3. THE WRONG PLANS

Finally, no-return tax filing proposals were the wrong plans for easing the filing burden. Not only did they offer the wrong solution by conflicting with structural aspects of the federal income tax (family tax unit, multiple and progressive tax rates, proliferating deductions and credits, political preference for tax subsidies over direct subsidies), and by creating new compliance burdens for taxpayers, employers, businesses, and tax administrators. They also covered only a fraction of all taxpayers. While upper-bound estimates indicated that close to 65 million taxpayers might qualify for a no-return system,<sup>101</sup> lower-bound estimates pegged the number of eligible participants

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forty-six per cent of Forms 1099 were processed by the end of April (accelerating to ninety-five per cent by July's end and ninety-nine per cent by September's).

<sup>99</sup> Holtzblatt, *supra* note 74 at 22–23; Department of the Treasury, *supra* note 69 at 39; GAO, *Alternative*, *supra* note 73 at 17–19.

<sup>100</sup> This is not to say that the IRS failed to recognize or embrace the promise of e-filing and e-communication. In fact, it explicitly acknowledged the possibilities for a reformed filing regime due to technological innovation. “Electronic filing of information returns could be one way to get information returns processed in time to be used for a tax agency reconciliation system.” GAO, *Alternative*, *supra* note 73 at 17. As early as 1986, the IRS had launched initiatives aimed at facilitating electronic filing. See *ibid* at 16; Department of the Treasury, *supra* note 69 at 41–43.

<sup>101</sup> See *supra* note 80.

under ten million.<sup>102</sup> In addition, as noted above, the vast majority of eligible participants already filed simple returns such that moving to a no-return regime would reduce compliance burdens only marginally.<sup>103</sup> These same taxpayers also submitted their tax returns early in the filing season in disproportionate numbers, with an equally disproportionate number receiving refunds.<sup>104</sup> A no-return regime would have the effect of forcing these taxpayers to delay filing with a corresponding delay in receipt of refunds.

Perhaps most importantly, no-return systems frightened conservatives as well as progressives. Conservatives perceived a hidden, insidious agenda in calls for no-return systems, viewing them as a way to obscure the full extent of tax burdens and size of government. In the words of anti-tax ideologue Grover Norquist, “moving to a so-called return-free system will reduce people’s understanding of what exactly they’re paying, and their [reduced] focus on it will make it easier to raise taxes”<sup>105</sup> in order to pay for bigger government.<sup>106</sup> This argument—that is, easing the filing burden leads inexorably to more taxes and more government—has been part of neo-conservative economic thought for many years,<sup>107</sup> but rose to political prominence in the

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<sup>102</sup> Holtzblatt, *supra* note 74 at 17 (8.2 million); Burman, *supra* note 70 (8 million); Gale & Holtzblatt, *supra* note 74 at 483 (8 million).

<sup>103</sup> *Supra* note 90.

<sup>104</sup> See Holtzblatt, *supra* note 74 at 22; Department of the Treasury, *supra* note 69 at 24, 37–38.

<sup>105</sup> US, *President’s Advisory Panel on Federal Tax Reform: Statement of Grover G Norquist (transcript of meeting on 17 May 2005)* (Washington, DC: 2005) at 114. But see Holtzblatt, *supra* note 74 at 31, observing that payroll taxes operate under a withholding regime, “but concern about the financing of Social Security and Medicare benefits do not appear to have suffered as a result. Citizens can be made aware of their tax burdens (by, for example, end-of-year reports from the IRS) without incurring the burden of filing returns”.

<sup>106</sup> Thorndike, *supra* note 56 at 430 (withholding “makes things entirely too easy. By insulating the taxpayers from their tax bills, it vitiates the bonds of healthy fiscal stewardship”).

<sup>107</sup> See e.g. Gary S Becker & Casey B Mulligan, “Deadweight Costs and Size of Government” (2003) 46:2 *JL & Econ* 293; Walter Hettich & Stanley L Winer, “Economic and Political Foundations of Tax Structure” (1988) 78:4 *Am Econ Rev* 701; James B Kau & Paul H Rubin, “The Size of Government” (1981) 37:2 *Public Choice* 261; Allan H Meltzer &

1990s and 2000s. The withholding system came under particular fire from conservative politicians and commentators, with members of Congress sponsoring legislation, for instance, to “restore to taxpayers awareness of the true cost of government by eliminating the withholding of income taxes by employers and requiring individuals to pay income taxes in monthly installments.”<sup>108</sup> Never mind that empirical research debunked the connection be-

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Scott F Richard, “A Rational Theory of the Size of Government” (1981) 89:5 *J Pol Econ* 914; Geoffrey Brennan & James M Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge, UK: Cambridge University Press, 1980). This argument can be viewed as a subset of the more encompassing (and as empirically unsubstantiated) argument that tax cuts create spending cuts. For this larger claim, see Robert J Barro, “There’s A Lot to Like About Bush’s Tax Plan”, *Business Week* (24 February 2003) 28; Gary S Becker, Edward P Lazear & Kevin M Murphy, “The Double Benefit of Tax Cuts”, *Wall Street Journal* (7 October 2003) A20; Ronald Reagan, Address to the Nation on the Economy (5 February 1981) at 2, online: <<http://www.presidency.ucsb.edu>> (“Over the past decades we’ve talked of curtailing government spending so that we can then lower the tax burden. Sometimes we’ve even taken a run at doing that. But there were always those who told us that taxes couldn’t be cut until spending was reduced. Well, you know, we can lecture our children about extravagance until we run out of voice and breath. Or we can cure their extravagance by simply reducing their allowance”). For research refuting this claim, see Michael Kumhof, Douglas Laxton & Daniel Leigh, “To Starve or Not to Starve the Beast” International Monetary Fund (IMF) Working Paper 10/199 (np: IMF, 2010) at 23 (finding “no support for the idea that ‘starving the beast’ is a foolproof way to achieve higher output and welfare. In fact, under many plausible circumstances, it could lead to precisely the opposite outcome.”); Michael J New, “Starve the Beast: A Further Examination” (2009) 29:3 *Cato Journal* 487; Andrew T Young, “Tax-Spend or Fiscal Illusion?” (2009) 29:3 *Cato J* 469; Christina D. Romer and David H Romer, “Do Tax Cuts Starve the Beast?: The Effect of Tax Changes on Government Spending”, National Bureau of Economic Research (NBER) Working Paper No 13548 (2007) at 1; Bruce Bartlett, “Starve the Beast’: Origins and Development of a Budgeting Metaphor” (2007) 12:1 *Independent Review* 5; William A Niskanen, “Limiting Government: The Failure of ‘Starve the Beast’” (2006) 26:3 *Cato Journal* 553; William G Gale & Peter R Orszag, “Bush Administration Tax Policy: Starving the Beast?”, *Tax Notes* 105:8 (15 November 2004) 999.

<sup>108</sup> US, Bill HR 3601, *Cost of Government Awareness Act of 2007*, 110th Cong, preamble, online: <<http://www.govtrack.us>>. See also Shlaes, *supra* note 4 at 8; Milton Friedman & Rose D Friedman, *Two Lucky People* (Chicago: University of Chicago Press, 1998).

tween withholding and increased tax payments to feed Leviathan.<sup>109</sup> Never mind, too, that requiring taxpayers to write regular checks to the government would have “increase[d] the visibility of the tax burden, but it is also highly inefficient.”<sup>110</sup> In many respects, that was the point.

Progressives also feared that return-free filing obscured tax burdens and depersonalized tax filing. But this was not because they were worried taxpayers would be lulled into complacency and tricked into cutting bigger and bigger checks to fund an increasingly bloated government. Rather, they objected to the lack of transparency that accompanied return-free filing. “Opaqueness is not good for democracy”, public finance economist Joel Slemrod wrote.<sup>111</sup> “A no-return system”, agreed Brookings Institution director William G. Gale and Treasury Department economist Janet Holtzblatt, “is likely to leave people less aware of the tax system they face and hence of the tax consequences of their actions.”<sup>112</sup> “A well-informed citizenry”, they continue, “can in principle make better economic and political choices.”<sup>113</sup> In fact, as noted earlier, tax filing can promote civic-mindedness and republican virtue, in addition to reinforcing citizenship obligations and highlighting both the benefits and burdens of taxpaying. In the end, a return-based filing requirement “represents an appropriate compromise on the level of visibility

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<sup>109</sup> See e.g. Libor Dušek, *Do Governments Grow When They Become More Efficient? Evidence from Tax Withholding* (PhD Thesis, University of Chicago Department of Economics, 2003).

<sup>110</sup> Joel Slemrod, “Taxation and Big Brother: Information, Personalization, and Privacy in 21st Century Tax Policy” (2006) 27:1 *Fiscal Studies* 1 at 10.

<sup>111</sup> *Ibid* at 12.

<sup>112</sup> Gale & Holtzblatt, *supra* note 74 at 484.

<sup>113</sup> *Ibid*. In thoughtful reflection, Holtzblatt queried whether less information necessarily leads to detached and disinterested citizen-taxpayers. “[T]he link between filing and understanding may be overblown. Payroll taxes in the United States operate under a no-return system for almost all taxpayers, but interest in Social Security and Medicare does not appear to have suffered as a result.”

and painfulness of taxation, and the filing of a tax return can serve an important ceremonial function as an expression of fiscal citizenship.”<sup>114</sup>

## B. THE PROMISE OF A DATA RETRIEVAL SYSTEM

Given bipartisan opposition to a no-return regime, future reforms to the filing process must embrace a filing requirement.<sup>115</sup> Such a plan exists, and has been gaining momentum as a policy alternative. Commonly referred to as “data retrieval”, this reform would allow taxpayers and their tax professionals to view, access, and download tax account information from a secure database maintained by the federal government. The inventory would include third-party reported information including wages, interest income, dividends, income from sale of securities, state taxes paid, and some of the most popular itemized deductions such as the tax subsidy for mortgage interest. Rather than having to gather all this information themselves and in piecemeal fashion from employers, financial institutions, and other third parties, taxpayers would be able to rely on a centralized clearing house from which they and their tax advisors could download the information directly onto returns. Taxpayers would still need to input some tax information not reported by third parties,<sup>116</sup> such as charitable contributions and certain capital

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<sup>114</sup> See e.g. Zelenak, *supra* note 33 at 56. See also Toder, *supra* note 92 at Slide 15 (considering a filing requirement as a way to reinforce “responsibility of citizenship”, “awareness of costs of government”, and “transparency of tax burdens”).

<sup>115</sup> This injunction necessarily means that tax simplification reforms based on eliminating the filing requirement should be rejected, however otherwise meritorious. For one such plan, see Michael J Graetz, “100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System” (2002) 112:2 Yale LJ 261 at 284 (arguing for a plan where the vast majority of taxpayers “would not be required to file any tax returns. They would have no dealings at all with the IRS”).

<sup>116</sup> If data retrieval were incorporated into fundamental tax reform that, for instance, exempted certain kinds of income from taxation or restricted the use and value of deductions by establishing a flat rate of tax and/or a floor, fewer taxpayers would have to supplement the database with additional information: see *infra* notes 124–128 and accompanying text.

gains, but a data retrieval system could simplify filing for all taxpayers—all 144 million of them.<sup>117</sup>

A particularly opportune policy moment has emerged for reforming the filing regime with a data retrieval platform. For several years, tax experts and scholars have been laying the groundwork for the idea.<sup>118</sup> More recently, President Obama's Economic Recovery Advisory Board, headed by former Federal Reserve Chairman Paul Volcker, endorsed data retrieval (along with a tax reconciliation system for unsophisticated returns) as a way to simplify the tax system and improve compliance.<sup>119</sup> Moreover, during the 2010 tax-filing season, IRS Commissioner Doug Shulman voiced support for the concept of data retrieval and individual taxpayer accounts maintained by the IRS containing information returns from third parties that taxpayers and tax professionals could access and download onto returns.<sup>120</sup> Indeed, supporters from across the political spectrum have come to embrace the common-sense conclusion expressed by Stanford law professor Joseph Bankman: “[s]ooner or later, it's too stupid for the government to have these records and for you not to be able to download these forms.”<sup>121</sup> In the parlance of political scientists, several policy “streams” have been converging, and a unique “policy window” has opened through which data retrieval might be pushed successfully.<sup>122</sup> Or, as John Kingdon describes the moment, “[a] problem is recognized, a solution is available, the political climate makes the time right for change, and the constraints do not prohibit action.”<sup>123</sup>

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<sup>117</sup> See IRS, *supra* note 68.

<sup>118</sup> See e.g. Joseph Bankman, “Using Technology to Simplify Individual Tax Filing” (2008) 61:4 Nat'l Tax J 773; US, Electronic Tax Administration Advisory Committee, *ETAAC Annual Report to Congress* (20 June 2007).

<sup>119</sup> See PERAB, *supra* note 64 at 41–44.

<sup>120</sup> Internal Revenue Service, Press Release, IR-2011-38, “Prepared Remarks of IRS Commissioner Doug Shulman at the National Press Club” (6 April 2011).

<sup>121</sup> Mark Roth, “Tax Reform Plan Would Shift Tax Return Preparation to the IRS”, *Pittsburgh Post-Gazette* (23 March 2008), online: <<http://www.post-gazette.com>>.

<sup>122</sup> See John W Kingdon, *Agendas, Alternatives, and Public Policies* (New York: Longman, 1984) at 129–30, 173–204 for the seminal discussion of this “multiple stream” model.

<sup>123</sup> *Ibid* at 93.



We have already considered the problem (unduly burdensome filing requirements) and available solution (data retrieval). The emergent policy window also enjoys an opportune political climate in the form of bipartisan support for fundamental tax reform based on simplification, compliance, and growth. Moreover, there do not appear to be any significant constraints. In fact, data retrieval sidesteps the obstacles that derailed earlier reform plans.

Momentum for fundamental tax reform in the mode of plugging loopholes to pay for rate reduction may be accelerating.<sup>124</sup> In December 2010, a bipartisan majority of the members of the President's National Commission on Fiscal Responsibility and Reform endorsed sweeping reforms to the federal income tax that would include, among other things: fewer, flatter, and lower rates (three total rates of 12, 22, and 28 per cent); a standard deduction for all taxpayers; repeal of all itemized deductions; repeal of the Alternative Minimum Tax (AMT) (effectively, a parallel tax system to the income tax that hits unwitting upper-middle income taxpayers with higher tax bills); taxing capital gains and dividends at ordinary rates (rather than at favorable capital gain rates); transforming the deduction for mortgage interest into a twelve per cent non-refundable credit, limiting principal debt to \$500,000, and eliminating current subsidies for second homes and equity lines of credit; and similarly transforming the deduction for charitable contributions into a twelve per cent credit, and further limiting the subsidy to contributions that exceed two per cent of adjusted gross income.<sup>125</sup> Several of the recommendations, moreover, embraced reforms proposed earlier in the year by Senators Ron Wyden, a Democrat, and Judd Gregg, a Republican.<sup>126</sup> In addition, President Obama announced his intention to pursue fundamental tax

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<sup>124</sup> See Joseph J Thorndike, "Why Liberals Should Like Tax Reform," *Tax Notes* 129:11 (13 December 2010) 1172.

<sup>125</sup> US, National Commission on Fiscal Responsibility and Reform, *The Moment of Truth* (Washington, DC: White House, 2010) at 31.

<sup>126</sup> See US, Bill S 3018, *Bipartisan Tax Fairness and Simplification Act of 2010*, 111th Cong, 2010.

reform over the next two years of his administration.<sup>127</sup> The growing enthusiasm for simplifying the tax system not only increases the likelihood that reformers will tackle tax filing. Combining tax reform with tax-filing reform might also ensure that the reforms last; subsequently reinstating tax preferences and targeted subsidies would reintroduce complexities and inefficiencies, and once again raise the burden on tax filing to unconscionable levels.<sup>128</sup>

A developing tax reform moment is not the only factor propping open the policy window through which a new filing regime could pass. Just as importantly, the electronic and technological revolution of the last twenty-five years has remade the way Americans pay taxes and how the government administers the tax system. In 1990, slightly more than four million taxpayers submitted their returns electronically.<sup>129</sup> By 2000, that figure jumped to 35 million,<sup>130</sup> while last year nearly 100 million filers, representing almost seventy per cent of all taxpayers, e-filed their returns either through tax professionals or by themselves.<sup>131</sup> The growth reflects several parallel developments, including the pervasiveness of home computers, taxpayer-consumers' growing comfort with conducting their financial affairs online, and an emergent tax-preparation software industry. It also reflects an aggressive effort at the IRS to encourage electronic filing as a way to ease the filing burden for taxpayers, third parties, and tax regulators.<sup>132</sup> For taxpayers, e-filing reduces tax preparation time and costs, speeds up payments and refunds, reduces common errors, and provides immediate acknowledgement of receipt. Meanwhile, for third parties and tax administrators, e-filing compared to paper

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<sup>127</sup> Jackie Calmes, "Obama Weighing Broad Overhaul for Income Tax," *New York Times* (10 December 2010) A1; Shamik Trivedi, "Obama Promises to Push for Tax Reform for 2013" 129 *Tax Notes* 129:11 (13 December 2010) 1162.

<sup>128</sup> See Holtzblatt, *supra* note 74 at 30.

<sup>129</sup> Department of the Treasury, *supra* note 69 at 43.

<sup>130</sup> *Ibid.*

<sup>131</sup> IRS, News Release, IR-2010-112, "Nearly 70 Percent of Taxpayers Used IRS e-file in 2010" (10 November 2010), online: <<http://www.irs.gov>>.

<sup>132</sup> See e.g. Department of the Treasury, *supra* note 69 at 41–43; GAO, *Alternative*, *supra* note 73 at 16–17 (for a discussion of the early efforts of the IRS in launching the first mass pilot program for electronic filing in 1986).

filing (or magnetic media for third-party payers) facilitates faster and less costly processing of tax returns and information returns with fewer errors. E-filing also produces greater security and privacy of taxpayer data.<sup>133</sup> As a way to further leverage these gains associated with e-filing and e-transmission of taxpayer data, the IRS has mandated that beginning in tax year 2011 all paid preparers acquire a Preparer Taxpayer Identification Number (PTIN), and, furthermore, that they file clients' tax returns through the IRS e-file program.<sup>134</sup> The Service is also targeting an ambitious e-filing participation rate of eighty per cent for all major individual, business, and exempt organizations by 2012,<sup>135</sup> while it continues to enhance its suite of e-services. The agency is in the process of replacing its existing e-filing platform with a modernized, Internet-based system that will provide all taxpayers (individual, business, non-profit) with real-time processing of returns and extensions, improved error detection, expedited acknowledgements, and the ability to attach supporting documents to e-filed returns.<sup>136</sup>

The revolution in electronic filing made possible by a modernized technological infrastructure at IRS and among third-party payers makes data retrieval a supremely viable policy option. E-filing and e-communication has sped up transmission of taxpayer account information from employers and third-party payers to the government. By all accounts, the income tax is al-

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<sup>133</sup> US, General Accounting Office, *Information Security: IRS Electronic Filing Systems* (GAO-01-306) (Washington, DC: 2001) at 1, 6.

<sup>134</sup> See Jeremiah Coder & Nicole Duarte, "New PTIN System in Place After IRS Finalizes Regulations", *Tax Notes* 129:1 (4 October 2010) 12; Department of the Treasury, Internal Revenue Service, "Furnishing Identity Number of Tax Return Preparer", (30 September 2010) 75:189 *Federal Register* 30609. For the IRS e-file program, see IRS, *Information for e-file*, online: <<http://www.irs.gov>>.

<sup>135</sup> US, IRS Oversight Board, *Annual Report to Congress 2009* (Washington, DC: IRS Oversight Board, 2010) at 28.

<sup>136</sup> See US, Treasury Inspector General for Tax Administration (TIGTA), *System Errors and Lower than Expected Tax Return Volumes Affected the Implementation of the Modernized e-File System for Individual Tax Return Processing* (Ref No 2010-40-111) (Washington, DC: TIGTA, 8 September 2010); US, TIGTA, *Modernized e-File Will Enhance Processing of Electronically Filed Individual Returns, but System Development and Security Need Improvement* (Washington, DC: TIGTA, 26 May 2010).

ready a business-based regime with employers remitting more than seventy-five per cent of taxes collected through withholding, and then forwarding to the government (nearly all electronically) more than 300 million W-2 forms.<sup>137</sup> Third-party payers send in another 1.5 billion information returns reflecting a vast array of tax account information,<sup>138</sup> including: mortgage interest; general interest; student loan interest; brokerage sales; dividends; cancellation of indebtedness; original issue discount; qualified tuition and related expenses; payments by state and local governments such as unemployment benefits; rents and royalties; gambling winnings; distributions from individual retirement accounts, retirement or profit-sharing plans, annuities, or insurance contracts; proceeds from real estate transactions; Social Security benefits; distributions from Medical Savings Accounts; currency transaction reports; and partnership items.

This is not to say that transitioning from the current filing regime to one based on data retrieval would be costless. Employers and third-party payers would have to, at a minimum, make additional investments in third-party information reporting software, prepare and file new information returns, and further expedite the preparation and filing of returns. These tasks have been made significantly easier, however, since the government began considering tax-filing reforms nearly twenty-five years ago. They will be made easier still as technological advances continue to provide gains in cost saving, productivity, security, and privacy that can be brought to bear in reforming the tax-filing regime.

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<sup>137</sup> PriceWaterhouse Coopers, *Total Tax Contribution: How much do large U.S. companies pay in taxes?* at 22, online: <<http://www.pwc.com>> (citing seventy-five per cent of federal taxes collected annually); Business editors, News Release, "MBS Says Business Tax Deadlines Leave 'No Margin for Error'" (29 January 2003), online: <<http://allbusiness.com>> (citing more than 300 million forms provided to employees).

<sup>138</sup> US, Internal Revenue Service, *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance* (2 August 2007) at 20.

### C. DATA RETRIEVAL EXPLOITS GOVERNMENT'S CORE COMPETENCY TO EASE THE FILING BURDEN

Lingering concerns from earlier reform efforts may delay simplifying tax filing. But these concerns largely do not apply in the context of data retrieval. In fact, tax filing—particularly if based on the data retrieval model—reflects one of the few areas where the federal government enjoys an inherent competitive advantage over private sector firms. As this section explains, data retrieval capitalizes on and fulfills the government's core competency in bringing maximum efficiency to the filing process.

First, and as noted above, conservatives argue that no-return filing obscures the full extent of tax burdens, and leads to higher taxes and bigger government.<sup>139</sup> Also as noted above, empirical research disproves that assumption.<sup>140</sup> More importantly, filing reform based on a data retrieval platform does not blunt tax consciousness in the way that exact withholding or tax agency reconciliation might. Rather, the efficiency gains associated with data retrieval involve leveraging technological advances to provide a secure inventory of tax account information accessible by taxpayers and paid preparers that, if combined with an educative or communicative function as discussed in Part III of this Article, should raise rather than lower tax consciousness.

Second, some commentators have noted possible concerns that filing reforms requiring taxpayers to share personal information with employers or third parties about changed family circumstances and additional sources of income could infringe on taxpayer privacy.<sup>141</sup> Such concerns prevail, if at all, under exact withholding regimes, not under data retrieval, which merely inventories tax account information already provided by and in the possession of the taxpayer, her employer, and third parties. Moreover, privacy concerns have been substantially mitigated in a world where taxpayer-consumers con-

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<sup>139</sup> *Supra* note 107 and accompanying text.

<sup>140</sup> See *supra* note 109 and accompanying text.

<sup>141</sup> See e.g. Burman, *supra* note 70 (wondering whether exact withholding would “result in a loss in privacy, because individuals might, for example, have to report to their employers information about their family circumstances and other sources of income”); Slemrod, *supra* note 110; Goolsbee, *supra* note 74 at 21; Boisture, Lauber & Paz, *supra* note 87 at 6, 21.

duct more of their personal and financial affairs online, and where they provide more of their personal and financial information to retailers.<sup>142</sup>

Third, securing taxpayer information resonates as loudly today as twenty-five years ago when reformers began considering changes to tax filing. But like privacy issues, security concerns continue to recede into the background of a highly technological world. To be sure, security breaches occur, such as the breach that shut down the British government's self-assessment tax return website in 2008.<sup>143</sup> But on the whole, transmitting taxpayer information electronically is a considerably safer proposition than sending 145 million paper returns and more than 100 million refunds through the mail.<sup>144</sup> Currently, electronic transmission of taxpayer information is based on e-security and e-authentication protocols that comport with financial industry standards for authenticating banking customers. The platforms supporting both the IRS e-file program<sup>145</sup> and California's ReadyReturn,<sup>146</sup> for instance, employ multi-factor authentication standards, which verify a person's identity through a combination of user names, security questions, and unique, non-static, expiring passwords that make communicating with tax officials as secure as banking online. Under these e-filing programs, taxpayers identify themselves by providing personal information (first, middle, and last name; Social Security number; email address; adjusted gross income from prior year's tax return), answering security questions (mother's maiden name; first pet; favorite

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<sup>142</sup> See e.g. Slemrod, *supra* note 110 at 11.

<sup>143</sup> See Elinor Mills, "British Tax Site Goes Dark after Data Security Breach", *CNET News* (3 November 2008), online: <<http://news.cnet.com>>.

<sup>144</sup> Indeed, the government annually prosecutes dozens of mail diversion schemes involving tax returns and tens of millions of dollars in refunds. See e.g. US Attorney Southern District of New York, Press Release, 10-008, "Bronx Man Sentenced in Manhattan Federal Court to 78 Months in Prison for Fraudulent Multimillion-Dollar Tax Refund and Theft of Mail Scheme" (7 January 2010), online: US Postal Service, Office of Inspector General <[www.uspsoig.gov](http://www.uspsoig.gov)>; US Attorney's Office, Southern District of New York, Press Release, "Arrests in Multimillion-Dollar Tax Refund and Mail Diversion Scheme" (26 February 2009), online: Federal Bureau of Investigation <<http://www.fbi.gov>>.

<sup>145</sup> See *supra* notes 131–136 and accompanying text.

<sup>146</sup> See *supra* note 77; California Franchise Tax Board, *ReadyReturn Service: Frequently Asked Questions* (FTB 971) (August 2007) at 4, online: <<http://www.ftb.ca.gov>>.

book), inputting a complex password (combining letters and numerals, measuring at least eight characters in length); and being shown a unique security image or “site key” that is familiar to the user. These tax agencies, like the financial industry, must balance security with convenience by providing safe transmission of sensitive information alongside ease of use. While they could easily increase security with more onerous identification and authentication standards, consumers (both taxpayers and banking customers) would balk at the accompanying loss of convenience.

Fourth, timeliness and availability of tax account information remains an issue, though not necessarily for data retrieval. Unlike tax agency reconciliation, data retrieval depends on the government depositing relevant tax information into a database rather than verifying and processing that information earlier in the filing season. E-filing of tax returns and information returns has already greatly expanded the processing of tax information for employers and third parties even as the number of returns continues to grow. Additional technological advances will provide further gains in cost saving, productivity, security, and privacy. Moreover, the government could require employers and third parties to transmit wage and income data earlier than the current March 31 deadline. In fact, that is what makes California’s ReadyReturn program work: the state requires employers to submit wage and income data by January 31, the *same* date that federal law requires employers to send the *same* data to employees (but which, inexplicably, needs not arrive in federal mailboxes until two months later). And although some tax information may never make it into a taxpayer’s account by April 15—because processing that information on behalf of taxpayers is either cost prohibitive for third parties or less efficient than placing the reporting burden on taxpayers, as with reporting certain charitable contributions or capital gains—adopting data retrieval without altering the existing tax system would still simplify tax filing for all 145 million taxpayers and their paid preparers.

Fifth, concerns about how filing reforms at the federal level would affect taxpayers who use information from the federal return to determine state income tax liability would also subsist under data retrieval. Recall that earlier concerns involved government-generated returns under a tax agency reconciliation regime arriving too late for taxpayers to rely on when calculating

state income tax liability;<sup>147</sup> they would still have to compute their state tax liability but without the assistance of the federal return, thus receiving no net benefit from switching to the new regime. By comparison, data retrieval provides one-stop shopping for taxpayers, and yields considerable net benefits in terms of cost, time, convenience, and reduced taxpaying anxiety, even in the event that the system never succeeded in inventorying all tax account information.

Finally, some commentators question whether achieving efficiencies in tax filing are better left to the private sector. Government involvement in easing the filing burden, the argument goes, “would reduce competition in existing [tax preparation] markets,” and “have the unintended effect of reducing innovation in rapidly evolving software markets.”<sup>148</sup> While it is true that government generally should not enter markets with active and engaged private sector firms (particularly if such intervention reduces competition),<sup>149</sup> this concern is inapposite in the context of tax filing.<sup>150</sup> Indeed, the federal government enjoys a competitive advantage when it comes to maximizing efficiencies in the filing process due to various taxpayer confidentiality laws. Section 6103 of the Internal Revenue Code makes the IRS responsible for safeguarding taxpayer account information, and subjects it to numerous dis-

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<sup>147</sup> See *supra* notes 98–99 and accompanying text.

<sup>148</sup> Joseph Cordes & Arlene Holen for the Technology Policy Institute, *Should the Government Prepare Individual Income Tax Returns?* (2010) at 16, online: Social Science Research Network <<http://papers.ssrn.com>>. See also Boisture, Lauber & Paz, *supra* note 87 at 23 (“No compelling case has been made that government could provide this service at a lower cost than that at which it is already provided by the private sector”).

<sup>149</sup> See Joseph E Stiglitz, Peter R Orszag & Jonathan M Orszag for the Computer & Communications Industry Association, *The Role of Government in a Digital Age* (October 2000), online: Economic Policy Institute <<http://archive.epinet.org>>.

<sup>150</sup> The most recent research advancing this argument is not altogether independent as it has been funded by technology and computer trade associations (including The Technology Policy Institute and The Computer & Communications Industry Association) whose paying members include tax preparation software firms (prominently Intuit, manufacturer of TurboTax) that view filing reforms designed to help taxpayers as a threat to their business. See e.g. Cordes & Holen, *supra* note 148; Boisture, Lauber & Paz, *supra* note 87. Indeed, the conclusions reached in these studies largely reflect the objections of the technology and computer industry.



closure prohibitions.<sup>151</sup> The strictures of 6103 do not apply to private firms that process and forward tax returns and information returns to the IRS. But such firms are subject to other safeguarding and privacy rules that impose a duty to ensure the security and confidentiality of taxpayer data,<sup>152</sup> and to provide privacy notices to all taxpayers explaining how they collect and maintain the information.<sup>153</sup> In addition, paid preparers—a category including tax prep software developers—face civil as well as criminal penalties for unauthorized disclosure or use of taxpayer data.<sup>154</sup>

Data retrieval leverages the government's competitive advantage and core competency in the area of tax filing. Under current law, the private sector is prohibited from providing a comparable service whereby a firm (or firms) would maintain a centralized database containing confidential tax accounts, supply the account with information from prior years' tax returns as well as current-year information from employers and third parties, update its contents as information trickles in during the filing season, make the account accessible to taxpayers and paid preparers, and permit authorized parties to download account information directly onto individual tax returns. Only the government can bring these efficiencies to the filing process, and ease the filing burden for 145 million taxpayers.

In fact, tax filing represents one of the few places where government can overcome the "Baumol Effect" or "Baumol's cost disease".<sup>155</sup> As identified by Princeton economist William Baumol in the 1960s, this phenomenon explains the difficulty in increasing output in industries that are not capital intensive despite ineluctably rising unit costs. Baumol first applied the theory to the performing arts where its effect is readily discernible. For one example, it takes four highly skilled musicians in 2011 the same amount of time to perform live a Beethoven string quartet as it did in 1800, while other costs of

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<sup>151</sup> *Internal Revenue Code*, 26 USC, § 6103 (2010).

<sup>152</sup> *Gramm-Leach-Bliley Act*, 15 USC, §§ 6801–09.

<sup>153</sup> *Ibid.*

<sup>154</sup> *Internal Revenue Code*, 26 USC, §§ 6713, 7216 (2010).

<sup>155</sup> See William J Baumol & William G Bowen, *Performing Arts: The Economic Dilemma* (Cambridge, MA: MIT Press, 1966) (the seminal articulation of this phenomenon).

production have gone up in the meantime. Government, another labour-intensive industry, suffers from a similar “productivity lag”, such that public goods (education, law enforcement, health care) get more expensive relative to private goods but fail to achieve commensurate productivity gains. The result is that taxpayers pay more in taxes but receive less in return. In the arena of tax filing, however, the government is uniquely positioned to reap productivity gains from increased infrastructure investment. The equally unique result is a higher-quality product for taxpayers at lower cost. Reforming the filing regime by adopting a data retrieval system would deliver benefits simply unattainable through private sector alternatives, including savings in cost and time for taxpayers, reduced anxiety and uncertainty surrounding the filing process, and a more efficient and customer-friendly interface linking taxpayers and their tax advisors with the government.

#### **IV. COMMUNICATING WITH TAXPAYERS AND PAID PREPARERS WHILE PROMOTING TAX CONSCIOUSNESS THROUGH RESPONSIVE REGULATION**

Maximizing efficiencies in the filing process through data retrieval accomplishes even more than lower costs and reduced burdens for taxpayers. To be sure, both are significant accomplishments, making life easier for 145 million filers. But data retrieval provides additional benefits for taxpayers, tax professionals, and tax regulators. In particular, it offers an opportunity to communicate with citizen-taxpayers in a new way, one that promotes tax consciousness through responsive regulation; that is, a form of regulation that eschews the traditional command-and-control approach for one that promotes a cooperative, dialogic, dialectic, pluralist, and deliberative partnership between regulators and those entities they regulate. Responsive regulation involves supporting and rewarding compliant behaviour through a collaborative approach, while being ready to escalate to punitive sanctions only when dialogue fails. In other words, according to its most influential proponent, John Braithwaite, responsive regulation is “firm yet forgiving in its demands for compliance. Reform must be rewarded just as recalcitrant refusal to reform

ultimately is punished”.<sup>156</sup> In the end, “[t]he paradox of responsive regulation is that by having a capability to escalate to tough enforcement, most regulation can be about collaborative capacity building”.<sup>157</sup>

The remainder of this article discusses how data retrieval, particularly its communicative function, reflects and reinforces the basic tenets of responsive regulation, and promises to create a more informed, engaged, and participatory citizenry.

As conceived by its progenitors, the heart of responsive regulation is “informed by a set of values that define not only a just legal order, but a caring civil society”.<sup>158</sup> These values embody civic republicanism in that they maximize freedom through “non-domination”.<sup>159</sup> “[B]y only resorting to more dominating, less respectful forms of social control when more dialogic forms have been tried first, coercive control comes to be seen as more legitimate”, and when regulation is viewed as “more legitimate, more procedurally fair, compliance with the law is more likely”.<sup>160</sup>

The tax filing moment offers an opportunity to promote these republican virtues. To the extent that we wish to communicate with taxpayers in an open, two-way exchange, what better time to reach out than the months and weeks leading up to April 15 when taxpayers are arguably most engaged with—or at least acutely aware of—their taxpaying obligations. Thanks to

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<sup>156</sup> John Braithwaite, “The Essence of Responsive Regulation” (2011) 44:3 UBC L Rev 475 [Braithwaite, “Essence”] at 484.

<sup>157</sup> *Ibid* at 475.

<sup>158</sup> *Ibid* at 485.

<sup>159</sup> *Ibid* at 485. See also John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford: Oxford University Press, 2002) at 12–16; Philip Pettit, *Republicanism: A Theory of Freedom and Government* (Oxford: Oxford University Press, 1997); John Braithwaite & Philip Pettit, *Not Just Deserts: A Republican Theory of Criminal Justice* (Oxford: Oxford University Press, 1990).

<sup>160</sup> Braithwaite, *supra* note 156 at 486. See also Tom R Tyler, “Trust and the Rule of Law: A Law-Abidingness Model of Social Control” (2001) [unpublished, archived at Australian National University Digital Collections]; Tom R Tyler & Steven L Blader, *Cooperation in Groups: Procedural Justice, Social Identity, and Behavioral Engagement* (Philadelphia: Psychology Press, 2000); Tom Tyler, *Why People Obey the Law* (Princeton: Princeton University Press, 2006).

the revolution in e-communication, tax regulators can readily respond to the concerns of taxpayers and their tax advisors, even in real time. In the language of responsive regulation, the government can “listen actively” and “structure dialogue” that, among other things, “gives voice to stakeholders” and “settles agreed outcomes” in advance, such as how to treat certain income or expense items.<sup>161</sup>

The communicative function of data retrieval is readily apparent. A data retrieval platform, for instance, could respond directly to taxpayer questions by better explaining and communicating information already on the return or information relevant to preparing and submitting the return. Such a platform could also relay specific information about changes in the tax law depending on a taxpayer's individual circumstances. Moreover, it could provide hyperlinks for taxpayers to communicate with the IRS Taxpayer Advocate, local IRS offices, elected representatives to Congress, and perhaps even an “IRS Complaint Department”.

If we were truly serious about the communicative function giving “voice to stakeholders”, we might consider allowing taxpayers to direct a capped portion of their tax refund to a government agency or department of their choice.<sup>162</sup> We might even consider allowing tax payments to be similarly earmarked if we were confident the policy would not significantly disrupt or reshuffle regular appropriations. Ideally, agency or department recipients of these taxpayer funds would subsequently send annual reports to “taxpayer-investors” describing the operational performance of the past year and outlook for the following year, including a readily accessible budget description. Depending on how taxpayers responded to this funding opportunity, one could envision government agencies competing for taxpayer dollars with detailed proposals and prospectuses.<sup>163</sup>

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<sup>161</sup> Braithwaite, *supra* note 156 at 476.

<sup>162</sup> See e.g. Ethan Porter, “Can’t Wait ‘Til Tax Day!” *Democracy* 16 (Spring 2010), online: <<http://www.democracyjournal.org>> for a proposal allowing taxpayers to earmark a supplemental payment to government agencies or departments.

<sup>163</sup> See *Internal Revenue Code*, 26 USC § 170(c)(1) (under current US tax law, the earmarked refunds (not the tax payments themselves) would be tax deductible as charitable contributions; it would be up to Congress to decide whether those contributions should continue receiving favorable tax treatment).

The communicative function of a data retrieval platform could also relay educational information directly to taxpayers. Such information could pertain to tax filing or to the tax system, but it could also involve the larger tax and transfer system by transmitting, for instance, public health messages describing the benefits of regular exercise or a balanced diet. Of course, the government would have to be careful about how much information it attempts to convey, as taxpayers can only be expected to process perhaps one to four pieces of information before the communicative function begins to yield declining marginal utility.<sup>164</sup> It would also be difficult to remain politically neutral in selecting what information to include when communicating with taxpayers. In fact, a “tax civics” function for data retrieval might generate sufficient political controversy to undermine the system’s legitimacy, and thus ultimately militate against meshing the personal tax filing function too closely or overtly with the civics function. Finally, at some point, the government might be better served simply giving back to taxpayers some of the savings in time gained from adopting data retrieval. As noted above,<sup>165</sup> the time spent filing one’s taxes can be monetized, and we may not want to use up all the efficiencies of an improved filing regime with the communicative function. It may turn out, for instance, that a five- or ten-minute informational message could end up “costing”, say, \$500 million a year in taxpayer time and, on net, not worth the expense.

Still, conveying at least some information to taxpayers during the filing process serves a critical role in enabling taxpayers to make accurate and informed cost-benefit analyses. Currently, taxpayers cannot aggregate the costs and benefits of taxpaying with any precision, because costs are easier to measure empirically and thus more salient to taxpayers who, in turn, assign them disproportionate weight. It is considerably more difficult to quantify

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<sup>164</sup> See George A Miller, “The Magical Number Seven, Plus or Minus Two” (1956) 63:2 *The Psychological Review* 81 (the capacity of short-term memory was believed to be limited to seven plus or minus two pieces or “chunks” of information); Nelson Cowan, “The Magical Mystery Four: How Is Working Memory Capacity Limited, and Why?” (2010) 19:1 *Current Directions in Psychological Science* 51 (since then, research suggests the capacity of short-term memory is even more restricted, particularly in the absence of note taking, to four pieces of information).

<sup>165</sup> See *supra* notes 65–69 and accompanying text.

the personal value of dispersed public benefits such as law enforcement, public health and safety, political and economic stability, interstate highways, transportation systems, and the convenience of sending first-class mail anywhere in the continental United States for \$0.44. Taxpayers are even more likely to overestimate the burden side of the benefit/burden ledger during the agonizing months of tax season. Ill-informed taxpayer-citizens become susceptible to anti-tax, anti-government rhetoric, and begin making decisions about government, politics, and policy from ignorance rather than from knowledge. The informational function of tax filing can balance taxpayer-citizens' understanding of the relationship between the benefits and burdens of taxation, and, in the process, create a more informed citizenry.

Basic confusion about the tax system leads to gross misperceptions over the burden and distribution of taxes that can have a dramatic impact on the tax system. A few years ago, Joel Slemrod found that a near majority of respondents to a national poll endorsed repealing the federal income tax due primarily to misconceptions over the incidence of the tax.<sup>166</sup> In particular, respondents erroneously believed that proposals for either a flat tax or a national retail sales tax would fall more heavily on wealthy taxpayers than the existing progressive income tax. Indeed, the "general population's incredible ignorance about taxes" threatens meaningful discussion over the role of taxes in our society.<sup>167</sup> Americans regularly confuse statutory and marginal rates, for instance, believing that if they are "in" the 35 per cent tax bracket all of their income is subject to the 35-per cent rate rather than just their last dollars earned. In other words, they do not understand that lower portions of their income fall into the 10 per cent, 15 per cent, 25 per cent, 28 per cent, and 33 per cent brackets, and that income earned only beyond a certain point falls into the 35 per cent bracket. Additional distinctions between marginal, average, and effective rates are no less perplexing to the average tax-

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<sup>166</sup> See Joel Slemrod, "The Role of Misconceptions in Support for Regressive Tax Reform" (2006) 59:1 Nat'l Tax J 57.

<sup>167</sup> See Marjorie E Kornhauser, "Educating Ourselves Towards A Progressive (And Happier) Tax: A Commentary On Griffith's *Progressive Taxation And Happiness*" (2004) 45:5 BC L Rev 1399 at 1403-06.

payer.<sup>168</sup> The same can be said for the difference between deductions and credits,<sup>169</sup> as well as the extent to which the tax system excludes certain items altogether from income, such as gifts, pension benefits, and the value of health and medical care provided by employers.

A data retrieval system could relay useful information to taxpayers as a way to overcome tax and financial illiteracy. In so doing, it could fulfill a tenet of responsive regulation that aims to achieve outcomes “by support and education to build capacity”.<sup>170</sup> The data retrieval platform could offer taxpayers online tutorials, intelligently designed to give them precisely what they want, and inform them of nearby upcoming IRS educational workshops. In addition, it could direct taxpayers to free tax services, including several programs sponsored by the IRS: Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and Free File.<sup>171</sup> Moreover, it could link taxpayers to additional sources of tax information online.

In numerous ways, the filing season offers the government a chance to educate and connect with taxpayer-citizens. The IRS could borrow a communicative device from the Social Security Administration, and provide tax-

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<sup>168</sup> Marginal rates refer to the rate of tax on the last dollar earned; average rates reflect total tax liability (before exemptions, deductions, and credits) divided by total income; effective rates equal total tax liability minus available tax dispensations (that is, exemptions, deductions and credits) divided by total income. The average rate of tax will always be lower than the marginal rate, and the effective rate of tax will be lower still.

<sup>169</sup> The value of a deduction is tied to a taxpayer’s marginal tax rate and thus rises with increasing increments of income. For example, a deduction for a taxpayer falling into the 35 per cent tax bracket is worth \$0.35 for every dollar of tax deduction but only fifteen cents for a taxpayer in the fifteen per cent bracket, and zero dollars for the low-income taxpayer falling below the ten per cent bracket. A tax credit, meanwhile, provides a dollar-for-dollar reduction in tax liability and may even provide a cash subsidy. For example, a \$1,000 tax credit reduces tax liability by \$1,000 irrespective the taxpayer’s marginal tax rate (with the caveat that eligibility for tax credits phases out as income rises). If the tax credit is “refundable,” it may generate a cash subsidy. For example, a \$1,000 refundable tax credit for a taxpayer with tax liability of \$500 will offset the \$500 tax and result in a cash payment of \$500.

<sup>170</sup> Braithwaite, *supra* note 156 at 476.

<sup>171</sup> IRS, *Free Tax Return Preparation for You by Volunteers*, online: <<http://www.irs.gov>>; IRS, *Free File: Do Your Federal Taxes for Free*, online: <<http://www.irs.gov>>.

payers a short pamphlet entitled something like, “Your Income Tax Statement”, similar to the two annual documents forwarded to all current and future Social Security recipients, “Your Social Security Statement” and “Thinking of Retiring? Consider Your Options”. As law professor Marjorie Kornhauser envisions it, the statement could include general information about the tax system, tailored information about the taxpayer’s last two or three tax years, comparisons between the taxpayer and other taxpayers, and, of course, links for obtaining additional information.<sup>172</sup> Such an annual communication from the IRS would “reduce a sense of distance from the bureaucracy, give taxpayers a sense of ownership”, and “dispel many misperceptions that alienate taxpayers from the system”.<sup>173</sup> The educative function of the statement, moreover, could raise compliance by elevating tax literacy and instilling confidence in the tax system. And it could explicitly link tax burdens with everyday government services that taxpayers count on.<sup>174</sup> If made part of a data retrieval system, the pamphlet and any supporting documents could be dumped into taxpayers’ individual tax accounts early in the filing season for the taxpayer or her advisor to access or reference whenever they want.<sup>175</sup>

The possibilities for educating taxpayers about their tax system through data retrieval are endless. The platform could provide information pertaining

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<sup>172</sup> Marjorie E Kornhauser, “Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?” (2005) 18:1 *Can JL & Jur* 95 [Kornhauser, “Full Monty”] at 107–09. See also Arizona State University, *Tax Literacy Project*, online: <<http://www.law.asu.edu>> (Kornhauser put theory into practice by launching the Tax Literacy Project, which aims “to informally educate the public about basic aspects of taxation”).

<sup>173</sup> *Ibid* at 107.

<sup>174</sup> *Ibid*.

<sup>175</sup> Another of Kornhauser’s proposals deserves mention: requiring taxpayers to complete and submit an annual Form W-4: *ibid* at 110–11. Such a requirement would have the salutary effect of increasing the accuracy of taxpayers’ withholding at the same time that it raised compliance in the sense that taxpayers would be less likely to under-withhold on their taxes if they were forced to affirm and authenticate the under-withholding every year. Requiring updated withholding could also serve an educational function by indicating how changes in the tax law or changed personal circumstances (family status, number of dependents) influence tax liability.



to (i) the size of tax expenditures (over \$1 trillion in lost revenues every year)<sup>176</sup> as well as the distribution of these tax subsidies (heavily skewed in favor of high-income taxpayers);<sup>177</sup> (ii) what other taxpayers paid across income cohorts, by state, city, zip code, over time; (iii) sources of national and subnational tax revenue besides federal income taxes (payroll taxes, estate taxes, sales taxes, property taxes, state inheritance taxes, state income taxes, gasoline taxes, state and local fees and tolls); and (iv) how the US tax system compares to other countries in terms of tax bases and revenue collected as a percentage of GDP, as a percentage of goods and services, as a percentage of labor costs, and on income and profits (categories in which the United States ranks near the bottom of all OECD countries).<sup>178</sup>

Taxpayer-citizens could use as much tutelage with respect to how the government spends tax revenues as with taxes themselves. In June 2010, a national poll revealed that a majority of voters believe the \$1.3 trillion budget deficit could be solved without touching Social Security and Medicare (together, these two programs account for more than thirty per cent of the federal budget); instead, those polled thought government could close

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<sup>176</sup> See *supra* note 60.

<sup>177</sup> See Beadsie Woo et al, *Upside Down: The \$400 Billion Federal Asset-Building Budget* (Baltimore: Corporation for Economic Development & The Annie E Casey Foundation, 2010) at 16.

<sup>178</sup> One additional reform—and one with historical precedent—involves publicizing individual tax information. The *Revenue Act of 1934*, c 277, § 55, 680 at 698 contained such a requirement, though it was repealed almost immediately. See Marjorie E Kornhauser, “Shaping Public Opinion and the Law: How a ‘Common Man’ Campaign Ended a Rich Man’s Law” (2009) 73:1 Law & Contemp Probs 123 (describing the campaign to repeal the “pink slip,” the pink-colored form that taxpayers were required to fill out with certain tax information which then became record); Kornhauser, “Full Monty”, *supra* note 172 at 22. According to Kornhauser, such publicity, defined as the “dissemination of information” for educational purposes, could “foster social norms of compliance as well as strengthen more traditional enforcement techniques”. The problem with a publicity proposal from the perspective of this article is that it could fuel “bad” tax consciousness: see *supra* note 32 and accompanying text; Shoup, Blough & Newcomer, *supra* note 32 at 363. In fact, early tax consciousness scholars were similarly worried about the 1934 law: “[p]ublicity of the amounts paid by income-taxpayers encourages curiosity in one part of the general public and may cause resentment in the taxpayer”.

the gap by reining in government “waste”.<sup>179</sup> As one commentator noted of the polling data, “[e]lected officials cannot offer meaningful choices about changing revenue and spending unless voters appreciate where federal dollars currently go”.<sup>180</sup> Equally depressing results from a 2005 poll revealed that more than half of all respondents mistakenly believe the United States spends more on foreign aid (which comprises one per cent of the budget) than on Medicare and Social Security (which comprises more than thirty per cent of the budget).<sup>181</sup>

Good-government organizations have mobilized to combat this national ignorance with comprehensible and consumer-friendly explanations of where our federal tax dollars go, all of which a data retrieval platform could include for easy viewing in taxpayer accounts. The Center on Budget and Policy Priorities, for instance, publishes an annual primer timed to coincide with April 15 that uses easy to understand pie charts (as well as more detailed narrative explanations) describing major components of the \$3.5 trillion federal budget in 2010 (almost \$2.2 trillion of which is financed by tax revenues, \$1.3 trillion through borrowing).<sup>182</sup> For the current fiscal year, the CBPP publication showed that a full sixty-one per cent of the national budget is consumed by three categories: defense and security (twenty per cent), Social Security (twenty per cent), and Medicare, Medicaid, and the Children’s Health Insurance Program (twenty-one per cent).<sup>183</sup> The IRS includes a simi-

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<sup>179</sup> See Jim Kessler, Ryan McConaghy & Anne Kim, *New Third Way/Benson Strategy Group Poll on the Economy* (July 2010), online: Third Way <<http://www.thirdway.org>>.

<sup>180</sup> David Kendall & Jim Kessler, *A Taxpayer Receipt*, online: Third Way <<http://www.thirdway.org>> at 2.

<sup>181</sup> The Washington Post, Henry J Kaiser Foundation, Harvard University, *About Half of Americans Mistakenly Believe We Spend More on Foreign Aid Than on Medicare and Social Security* (3–6 February 2005), online: Public Agenda <<http://www.publicagenda.org>>.

<sup>182</sup> CBPP, *Basics*, *supra* note 9 at 1.

<sup>183</sup> *Ibid* at 2. Other groups depict federal spending in user-friendly formats as well, also conveniently during tax season. See also National Priorities Project, *Where Did Your Tax Dollars Go?* (April 2010), online: <<http://www.nationalpriorities.org>>.

lar set of pie charts with the annual instructional booklet for Form 1040, entitled, “Major Categories of Federal Income and Outlays.”<sup>184</sup>

Other organizations have called on the government to go one step further and publish an individualized taxpayer receipt showing where their taxes dollars go. One group, Third Way, published a policy paper in 2010 illustrating what such a receipt might look like. Using a taxpayer with annual income at the US median (\$34,140) and corresponding tax liability (\$5,400 for income and payroll taxes), the group produced an itemized receipt reflecting to what extent the taxes supported various government programs: \$1,040.70 for Social Security, \$625.51 for Medicare, \$229.17 for combat operations in Iraq and Afghanistan, \$46.08 for foreign aid, \$0.24 for funding the arts, \$0.19 for Congressional salaries and benefits, among other items.<sup>185</sup> In addition, just this year, several members of Congress sponsored the Taxpayer Receipt Act of 2011, which would provide every taxpayer an accounting, “similar to a grocery store receipt”, of where their payroll and income taxes go.<sup>186</sup> The Obama Administration, for its part, included a “taxpayer receipt calculator” on the White House website to help Americans “understand how and where your tax dollars are being spent”.<sup>187</sup> Even Google got into the act, sponsoring a contest “to create data visualizations that would make it easier for US citi-

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<sup>184</sup> The pie charts appeared on page 100 of the publication for tax year 2009, which ran an astonishing 175 pages in length. As part of its e-filing campaign, the IRS will stop mailing paper income tax packages and 1040 instructional booklets beginning in tax year 2010. See Internal Revenue Service, *1040: Instructions* (2009), online: <<http://www.irs.gov>> at 100.

<sup>185</sup> Kendall & Kessler, *supra* note 180 at 3.

<sup>186</sup> Scott Brown: United States Senator for Massachusetts, Press Release, “Brown, Nelson Introduce Taxpayer Receipt Act” (2 March 2011), online: <<http://scottbrown.senate.gov>>; US, Bill S 437, *Taxpayer Receipt Act*, 112th Cong, 2011, online: <<http://thomas.loc.gov>>. For criticism of the proposal, see Neil H Buchanan, *Taxes, Information, and Democracy* (24 March 2011), online: Dorf on Law <<http://www.dorfonlaw.org>>.

<sup>187</sup> The White House, *Your 2010 Federal Taxpayer Receipt*, online: <<http://www.whitehouse.gov>>.

zens to understand how the government spends our tax money”.<sup>188</sup> All of these efforts embody the simple observation of the CBPP, “[w]hen thinking about the costs that taxes impose, it is essential to balance those costs against the benefits the nation receives from public services”.<sup>189</sup>

Taxpayers have a right to reliable information pertaining to both the burdens and benefits of citizenship. A reformed tax-filing regime can help provide that information. Whatever policy alternative is chosen—this article has made the case for data retrieval—reformers cannot ignore paid preparers, who help more than sixty per cent of households every year fulfill their tax-filing obligations.<sup>190</sup> In fact, all indicators suggest that preparers would embrace a new system based on the data retrieval model.<sup>191</sup> Simply putting their clients’ tax information in one place would make preparers’ lives considerably easier. No longer would they have to track down dispersed information with

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<sup>188</sup> For the contest and the winners, see Data Viz Challenge, “The Challenge”, online: <<http://datavizchallenge.org>>; whatwepayfor.com, “What We Pay For”, online: <<http://www.whatwepayfor.com>>.

<sup>189</sup> CBPP, *Basics*, *supra* note 9 at 3. Other organizations provide online calculators for computing individual tax receipts. See e.g. *What We Pay For*, online: <<http://www.whatwepayfor.com>> and *Your Tax Receipt*, online: <<http://taxes.kareemshaya.com>>. The idea of an individualized taxpayer or budget receipt has roots in the 1990s when Senator Charles Schumer, then a member of the House of Representatives, introduced a bill, “The Taxpayer Right-To-Know Act,” which he, in turn, modeled on a similar taxpayer receipt produced by New York City’s Independent Budget Office. For a discussion of recent proposals a taxpayer receipt and some insight into its history, see OMB Watch, “No Taxation Without Information”, online: <<http://www.ombwatch.org>>.

<sup>190</sup> IRS, News Release, IR-2010-99, “New Online Registration System for Paid Tax Preparers is Now Available”, online: <<http://www.irs.gov>>.

<sup>191</sup> Preparers have long-supported IRS modernization efforts, particularly the move to electronic filing and communication. See e.g. Nicola M White, “TIGTA Calls IRS Rollout of New E-File System a ‘Challenge’”, *Tax Notes* 128:13 (27 September 2010) 1336 at 1337 (quoting an official with the National Association of Tax Professionals as praising enhancements to the IRS’s Modernized e-File system for the 2010 filing season, particularly the ability to attach electronic signatures, PDFs, supporting documents, and spread sheets); Jeremiah Coder, “Tax Analysts Exclusive Conversations: Frank Degen”, *Tax Notes* 120:13 (29 September 2008) 12 (quoting a member of the IRS Advisory Council and former President of the National Association of Agents saying, “e-services have been a big help to practitioners”).

respect to itemized deductions from lenders, banks, brokerage firms, property management services, states and municipalities. Nor would they have to deal with clients failing to tell them about 1099 income or income from rental properties, interest from investments, or even income unbeknownst to the client or lost to memory. A data retrieval system could also verify estimated tax payments, which clients regularly forget to satisfy throughout the year, think they satisfied but forwarded to the IRS without payment or with partial payment or in fact satisfied with a form of payment for which the IRS has no record.

Indeed, policymakers and tax officials ignore preparers at their peril. Not only because preparers form a powerful lobbying group, but also because they possess invaluable practical and professional knowledge that should inform any redesign of the filing process. Preparers provide the crucial link between taxpayers and tax officials, between success and failure of the individual income tax system and its long-term viability.

Members of the preparer community spend significantly more time communicating with the IRS than individual taxpayers. As such, their experiences, concerns, and suggestions should be given considerable weight in moving to a new filing regime. It is equally important to keep the lines of communication open once reforms are implemented. Soliciting the input of regulated actors—both preparers and taxpayers—and eliciting from them active responsibility reflect two of the basic tenets of responsive regulation.<sup>192</sup> Cultivating shared responsibility among regulated actors in upholding the integrity of the system feeds and reinforces a commitment to compliance such that the system becomes increasingly self-regulated. Taxpayers, for their part, begin to take responsibility for their actions vis-à-vis other taxpayers as the taxing agency becomes more responsive, establishing and committing to two-way communication.<sup>193</sup> For the same reasons, preparers begin to assume

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<sup>192</sup> See Braithwaite, *supra* note 156 at 508 (suggesting that regulators “engag[e] wider networks of partners,” and “enroll[] increasing numbers of more potent network partners to escalate pressure” on regulatees), 476 (calling for a system that promotes “active responsibility . . . for making outcomes better in the future” among regulated entities).

<sup>193</sup> Braithwaite, *supra* note 156 at 506 (indeed, as Braithwaite astutely observes, regulators must reflect and commit to the same behaviours they expect of the entities they regulate. “Regulators must be the change they want to see by communicating openly” with regu-

roles as pseudo tax officials, not only regulating each other but also taxpayer-clients, because they correctly view their own success as depending on the success of the system. As a result, preparers also educate themselves and their clients on penalties for noncompliance, which, under the responsive regulation model, would be designed with substantial and ongoing input from the preparer community.<sup>194</sup>

Compliant preparers and taxpayers, in turn, could be rewarded for committing to compliance beyond simply avoiding deficiency notices.<sup>195</sup> In the event they had a dispute over a return position, for instance, it could be fast-tracked for resolution. Or they might be afforded expedited pre-filing guidance to bypass currently slower procedures, such as requesting a Private Letter Ruling, which, if the Treasury Department considers at all, can take years to resolve.<sup>196</sup> Or, for that matter, compliant taxpayers and advisors could be given a seat at the table to reformulate existing rules or to craft new ones.

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lated entities. “More than that, they do best to include . . . industry in their processes” of designing regulatory rules and expectations).

<sup>194</sup> The preparers would be responding to—and reinforcing—another tenet of responsive regulation: “Signal, but do not threaten, a range of sanctions to which you can escalate; signal that the ultimate sanctions are formidable and are used when necessary, though only as a last resort”. See Braithwaite, *supra* note 156 at 504. The data retrieval platform presents all kinds of possibilities for “signaling, but not threatening” sanctions to taxpayers and preparers. First, through a data retrieval platform, tax officials could create a virtual, consumer-friendly, fully searchable library of tax laws and regulations, including potential penalties for failure to accurately report income, and ways to avoid inadvertent underpayment. Second, during the e-filing process, it could help taxpayers avoid these pitfalls by using pop-ups that ask, for instance, “Are you forgetting any other forms of income from this year?” or “We notice you indicated that you worked as a bartender this year; don’t forget that tips and cash must be reported as income”. And finally, it could fast-track for speedy and non-penal resolution of disputes those underpayments committed by taxpayers who, by all accounts, just made an honest mistake.

<sup>195</sup> Braithwaite, *supra* note 156 at 501 (stating that agencies practicing responsive regulation should “praise those who show commitment, support their innovation, nurture motivation to continuously improve, [and] help leaders pull laggards up through new ceilings of excellence”).

<sup>196</sup> TIGTA, *Chief Counsel Can Take Actions to Improve the Timeliness of Private Letter Rulings and Potentially Reduce the Number Issued* (Washington, DC: TIGTA, 10 September 2010) at 4.

Whatever method was chosen for rewarding compliance, it should involve listening, facilitating future dialogue, and “giv[ing] voice to stakeholders”.<sup>197</sup>

Finally, this communicative form of regulation reflected in a prospective data retrieval system should strive to evaluate successes and failures on an ongoing basis. Ideally, it would communicate lessons learned<sup>198</sup> (including instances of resistance and failure where opportunities for learning may be greatest),<sup>199</sup> value improvements to the system,<sup>200</sup> adapt to changed circumstances and expectations of taxpayers, paid preparers, and tax officials, reject dogmatism, and appreciate context.<sup>201</sup>

## V. CONCLUSION

This Article has recommended reforming the way people pay taxes with a proposal that significantly eases the burden for taxpayers and paid preparers, and communicates with taxpayer-citizens in a more responsive, dialogic fashion. By leveraging technology and exploiting the government’s core competency for maximizing efficiencies in filing taxes, the plan slashes costs (both monetary and psychological), and provides a consumer friendly, secure, and educational portal for paying taxes.

Specifically, a tax-filing regime based on a data retrieval platform allows taxpayers and paid preparers to view, access, and download tax account information from a secure database maintained by the government. The inventory could include wages, interest income, dividends, income from security

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<sup>197</sup> Braithwaite, *supra* note 156 at 493.

<sup>198</sup> See Braithwaite, *supra* note 156 at 512–18.

<sup>199</sup> Valerie Braithwaite has demonstrated that resistance to a regulatory regime can be healthy in that it creates opportunities for improving the system. See e.g. Valerie Braithwaite, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy* (2009); Valerie Braithwaite, *Dancing with Tax Authorities: Motivational Postures and Noncompliant Actions*, in Valerie Braithwaite, ed., *Taxing Democracy: Understanding Tax Avoidance and Evasion* 15 (2003). Or, as John Braithwaite describes the phenomenon: “[t]he character with which democratic governance responds to resistance is vital to the quality and resilience of a democracy”. Braithwaite, *supra* note 156 at 500.

<sup>200</sup> Braithwaite, *supra* note 156 at 503.

<sup>201</sup> See Braithwaite, *supra* note 156 at 490–493.

sales, state taxes paid, and some of the most popular itemized deductions such as mortgage interest. Rather than having to gather this information from employers, financial institutions, and other third parties, taxpayers and paid preparers could rely on a centralized clearinghouse. Taxpayers with sophisticated returns may still need to input information not reported by third parties, such as charitable contributions and some capital gains, but a data retrieval system would simplify filing for all 145 million tax filers.

Data retrieval provides more than an informational function. It offers an opportunity to communicate with taxpayers and their advisors, listen to concerns, meet needs, relay information, and improve the system. The communicative and educative function of a data retrieval system could turn the annual rite of taxpaying into a dialogue between citizens and their government, and an opportunity to improve fiscal literacy and raise tax consciousness. In this way, data retrieval reflects the modern regulatory theory of responsive regulation, which aims to open lines of communication between regulated entities and government regulators.

Finally, the government—and not the private sector—is uniquely positioned to lead this reform. Data retrieval leverages the government's competitive advantage and core competency in the area of tax filing. Under current taxpayer confidentiality laws, the private sector is prohibited from providing a comparable service for maintaining and updating a centralized database containing sensitive tax account information. Only the government can bring these efficiencies to the filing process, and ease the filing burden for all taxpayers.