Multibillion-Dollar Tax Questions

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Tax compliance in the United States historically hovers in the 80 percent range, costing the nation approximately half a trillion dollars annually in uncollected tax revenue. To foster greater tax compliance, the Internal Revenue Service (IRS) should employ whatever tools are at its disposal. Standard deterrence theory argues that increasing the audit rate and imposing stiffer penalties would foster greater tax compliance. There are political headwinds, however, that strongly suggest that these approaches are not currently viable. Instead, there is a low-cost method that could yield greater tax compliance. Drawing on recent and compelling social science research, the IRS should ask more information-revealing questions on tax returns. By engaging in this important exercise of strategic inquiries, dual benefits are likely to emerge: taxpayers would be more likely to report honestly to avoid acts of commission (e.g., lying); and the IRS would be in a better strategic position because it would possess additional, relevant information on taxpayer activities.

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I. INTRODUCTION

When taxpayers consider their tax return, the first thing that likely comes to mind is a tapestry of different numbers. How much is their gross income? How much may they deduct? What is the standard deduction this year, and how does it compare with the amount of their itemized deductions? In short, by populating their tax returns with numerical entries and making mathematical computations, most taxpayers believe that they have fulfilled their civic duties.

However, what these very same taxpayers often overlook on their tax returns is something that is of critical importance. More specifically, they fail to appreciate the important role that noncomputational questions play in the collection of vital information that may prove tax determinative. Most tax return questions seek numerical responses.[1] For example, typical questions are formulated with just a few words, and these questions are immediately followed by an accompanying blank space in anticipation of the taxpayer supplying a dollar figure (for example, the amount of wages earned).[2] By contrast, few tax return questions are expressed in a manner that solicits noncomputational information, which perhaps has only a tangential bearing upon one's tax liability but which can nevertheless prove pivotal in enhancing tax compliance.[3]

The focus of this Article is on these noncomputational questions. We argue that the IRS should, on the basis of recent and compelling social science research, formulate tax return questions that solicit specific, noncomputational information that would likely foster better tax compliance. In the process, we advance existing literature in the sphere of taxpayer noncompliance,[4] offering comprehensive and practical examples of how taxpayers can be "nudged" to be tax compliant. This is not merely an academic exercise—billions of dollars of tax revenue are at stake.[5]

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[1] *See, e.g.*, INTERNAL REVENUE SERV., FORM 1040 (2022), https://www.irs.gov/pub/irs-pdf/f1040.pdf [https://perma.cc/4VET-VDYE].

[2] *Id.*

[3] An exception, discussed further in Part IV, *infra*, is the following question on Form 1040: "At any time during 202[X], did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency?" *See, e.g.*, Amber Gray-Fenner, *IRS Adds New Guidance but Form 1040 Cryptocurrency Question Is Still Causing Confusion*, FORBES (Mar. 5, 2021), https://www.forbes.com/sites/ambergray-fenner/2021/03/05/irs-adds-new-guidance-but-form-1040-cryptocurrency-question-is-still-causing-confusion/?sh=56c4ae24699a [https://perma.cc/7TTF-L7FE]; INTERNAL REVENUE SERV., FORM 1040 (2020), https://www.irs.gov/pub/irs-prior/f1040--2020.pdf [https://perma.cc/HW38-NUER]. For an excellent discussion on the importance of raising such questions on tax returns, see Joseph Bankman, Clifford Nass & Joel Slemrod, *Using the "Smart Return" to Reduce Evasion and Simplify Tax Filing*, 69 TAX L. REV. 459, 460 (2016) (calling for the "redesign [of] the tax forms and online filing process to elicit more truthful responses from taxpayers").

[4] *See, e.g.*, Manoj Viswanathan, *Tax Compliance in a Decentralizing Economy*, 34 GA. ST. U. L. REV. 283, 283 (2018) ("Tax compliance in the United States has long relied on information from centralized intermediaries—the financial institutions, employers, and brokers that help ensure income is reported and taxes are paid."); Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7, 7 (2009) ("The tax gap, which measures taxpayer noncompliance with the tax laws, has bedeviled tax administrators since tax systems began.").

[5] *See* IRS, *Tax Gap Projections for Tax Years 2020 & 2021*, IRS PUBL. 5869 (2023), chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://www.irs.gov/pub/irs-pdf/p5869.pdf (indicating that for tax year 2021, the gross tax gap was estimated to be $688 billion and the voluntary compliance rate to be 84.9%); David Lawder, *IRS Chief Says $1 Trillion in Taxes Goes Uncollected Every Year*, REUTERS (Apr. 13, 2021), https://www.reuters.com/article/us-usa-treasury-irs/irs-chief-says-1-trillion-in-taxes-goes-

These proposed actions by the IRS can, in fact, be introduced without legislative approval, as part of existing statutory authority of the tax administration.[6] Recall that the IRS is charged with the mission to collect the country's tax revenue.[7] Accordingly, the Internal Revenue Code (Code) grants broad authority to the agency to take those administrative measures that it deems necessary to enhance tax compliance.[8] While Congress must enact tax legislation to generate tax revenue,[9] the legislative branch tasks the IRS with the duty to devise tax returns designed to achieve this outcome.[10]

The IRS should therefore craft tax returns and formulate questions in a manner that prods taxpayers to report honestly. Specifically, we show how social science research can assist in this endeavor. We explore how individuals are more reluctant to lie when asked to do so through an act of commission (for example, supplying a false answer to a "yes" or "no" question), while they generally find it easier to fabricate when they can do so through omission (for example, simply failing to add in cash income when reporting overall income).[11] The literature on this so-called omission bias suggests several specific tax questions that would provide the IRS essential—and qualitative—

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uncollected-every-year-idUSKBN2C0255 [https://perma.cc/2Z53-KUXE] ("The U.S. government is losing some $1 trillion in unpaid taxes every year and needs more and consistent Internal Revenue Service funding to go after tax cheats, IRS Commissioner Charles Rettig said on Tuesday."); Fred Goldberg & Charles Rossotti, *$574 Billion in Taxes Weren't Paid in 2019. Here's How to Shrink the Gap*, FORTUNE (Jan. 30, 2021), https://fortune.com/2021/01/30/income-unpaid-tax-gap-2021/ [https://perma.cc/PT9F-CS62] ("In 2019 the tax gap—taxes owed but not paid—was $574 billion.").

[6] I.R.C. § 7801(a)(1) (giving Secretary of the Treasury authority to administer and enforce Tax Code); I.R.C. § 7803(a)(2) (listing duties of IRS Commissioner "as the Secretary may prescribe . . . ").

[7] *The Agency, Its Mission and Statutory Authority,* INTERNAL REVENUE SERV., https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority [https://perma.cc/3SFB-WE9V]. On the IRS website, the agency's delineated mission statement is as follows: "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." *Id.*

[8] *See* I.R.C. § 6001 ("Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.").

[9] *See* Benjamin G. Barokh, *The Meaning of "Incomes" in the Sixteenth Amendment*, 15 GEO. J.L. & PUB. POL'Y 409, 409 (2017) ("The Sixteenth Amendment, ratified in 1913, provides Congress with the 'power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.'").

[10] *See, e.g.*, Press Release, U.S. Dep't Treasury, Treasury, IRS Announce Development of Postcard-Size Form 1040 for 2019, (June 29, 2018), https://home.treasury.gov/news/press-releases/sm421 [https://perma.cc/Y7ML-YU8Y]; I.R.C. § 7803(a)(2).

[11] *See* Mark Spranca, Elisa Minsk & Jonathan Baron, *Omission and Commission in Judgment and Choice*, 27 J. EXPERIMENTAL SOC. PSYCH. 76, 76 (1991).

information on taxpayer activities.[12] Such information would, in turn, facilitate IRS enforcement efforts in areas where tax compliance is known to be particularly low, including cash receipts, virtual currencies, foreign bank accounts, household employees, and tax shelters.

The remainder of this Article justifies what we call "multibillion-dollar tax questions," along with providing concrete suggestions for their design. Part II discusses the role of information in tax administration and the ways in which technological changes have altered its flow to tax agencies. Part III discusses how social science research offers powerful insights into how acts of commission and omission differ, and surveys recent real-world studies that demonstrate how this distinction may affect taxpayer behavior. It then presents two case studies that depict how tax return questions have historically enhanced tax compliance. Part IV turns to reforms, discussing five areas identified by the IRS and other tax policy experts as being problematic for tax compliance and offering specific questions that the IRS could add to tax returns in order to bolster tax compliance in these areas. The Appendix to this Article includes a Form 1040 prototype with these suggested tax return questions incorporated. The final section of the Article concludes.

II. THE ESSENTIAL ROLE OF INFORMATION IN TAX ADMINISTRATION

Historically, a major issue plaguing tax administration has always been securing taxpayer information.[13] Even during much of the 20th century, the receipt of vital taxpayer information was limited.[14] A list of factors contributing to this phenomenon (which is not exhaustive) includes the following: (i) transactions were largely in cash, so there was no "paper trail" that could be used to verify tax return accuracy; (ii) third-party information was absent, so there was no independent verification of the dollar figures that taxpayers reported; (iii) tax withholding was not required, disincentivizing taxpayers' quests for refunds and concomitant tax return–filing fulfillment; (iv) tax shelters were shrouded in secrecy, which clouded the IRS's ability to detect hidden defalcations; and (v) many taxpayers hid income and assets in offshore accounts and shifted profits to low-tax jurisdictions, which, due to jurisdictional limitations, stymied the IRS in gaining access to information.[15]

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[12] *See infra* Part III.

[13] *See, e.g.*, Joel Slemrod, *Sexing Up Tax Administration*, 1 J. TAX ADMIN. 6, 18 (2015) ("Tax systems are, at their core, largely an issue of asymmetric information among the taxpayers, remitting agents, and the tax authority."); James Alm, *Devising Administrative Policies for Improving Tax Compliance*, 70 CANADIAN TAX J. 43, 56 (2022) ("The basic issue in tax administration has always been obtaining information about taxpayers and their activities . . . .").

[14] *Id.*

[15] *Id.*; *see, e.g.*, Susan Cleary Morse, Stewart Karlinsky, & Joseph Bankman, *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 39 (2009) (explaining the pervasive problem of the cash economy and accurate tax reporting); Leandra Lederman &

As most commentators concur, information asymmetry of the sort just described was and continues to be the largest single catalyst driving tax noncompliance.[16]

However, technological changes have fundamentally affected this information asymmetry by augmenting the flow of information to tax administrations.[17] Most of the technological changes started with the transformation of information storage into digital formats for use by computers.[18] Such technological change and its practical applications (or

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Joseph C. Dugan, *Information Matters in Tax Enforcement*, 2020 BYU L. REV. 145, 148 (2020) ("[A]symmetric information is a core problem for modern tax laws because the taxpayer knows the relevant facts—such as the details of the transactions that he or she engaged in—while the government does not."); Wei Cui, *Taxation Without Information: The Institutional Foundations of Modern Tax Collection*, 20 U. PA. J. BUS. L. 93, 96–97 (2017) ("But the government is always in a situation of information asymmetry vis-à-vis taxpayers: the latter always have incentives to hide such information. The government's ability to overcome such information asymmetry therefore must be crucial for tax collection."); Ajay K. Mehrotra, *"From Contested Concept to Cornerstone of Administrative Practice": Social Learning and Early History of U.S. Tax Withholding*, 7 COLUM. J. TAX L. 144, 147 (2016) ("In 1913, when the federal income tax became a permanent part of the U.S. tax system—on the heels of the ratification of the Sixteenth Amendment—Congress initially enacted a crude form of tax withholding and information reporting. It was soon eliminated, however, due to vociferous opposition from business interests and limited federal administrative capacity."); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215, 243 (2002) ("Many shelters are secret, and systematic data is difficult to obtain."); Tracy A. Kaye, *The Offshore Shell Game: U.S. Corporate Tax Avoidance Through Profit Shifting*, 18 CHAP. L. REV. 185, 185-86 (2014) (explaining how multinational companies seek to shift profits to those jurisdictions in which tax rates are low).

16 *See, e.g.*, Richard M. Bird, *Administrative Dimensions of Tax Reform*, 10 ASIA-PAC. TAX BULL. 134, 139 (2004) (noting that "a tax administration needs an information system to ascertain the existing tax base . . . includ[ing] the collection of information from potential taxpayers themselves, from third parties, and from internal sources of the tax administration"); Bas Jacobs, *Digitalization and Taxation*, *in* DIGITAL REVOLUTIONS IN PUBLIC FINANCE 25, 25 (Sanjeev Gupta, Michael Keen, Alpa Shah, & Geneviève Verdier eds., 2017) ("[I]nformation on economic outcomes and characteristics of taxpayers is not perfect. Information constraints lie at the heart of the traditional economic analysis of taxation. Government is not able to verify all economic outcomes of individuals or households. Indeed, taxpayers may misrepresent their incomes, consumption, wealth, or bequests to avoid or even evade paying taxes. Information constraints determine a government's tax enforcement capacity.")

17 These changes are more concentrated in developed countries, but, given the efforts of the International Monetary Fund and World Bank, they are also emerging even in developing countries. *See, e.g.*, ROEL DOM, ANNA CUSTERS, STEPHEN R. DAVENPORT & WILSON PRICHARD, WORLD BANK GROUP, INNOVATIONS IN TAX COMPLIANCE 93 (2022), https://openknowledge.worldbank.org/handle/10986/36946 [https://perma.cc/4VPT-YG33].

18 *See* James Alm, *Tax Evasion, Technology, and Inequality*, 22 ECON. GOVERNANCE 321, 324 (2021) ("Computers have opened the doors to a range of methods, all of which affect the flow of information to tax administrations, via: [i]nformation retrieval and

"digitalization") opened up new frontiers for governments to detect tax evasion, greatly improving their ability to track and then to analyze transactions that produce an electronic trail.[19]

Insofar as tax compliance is concerned, digitalization yields multiple benefits. It increases the ability of governments to retrieve information,[20] to transmit this information across jurisdictional borders,[21] to analyze this

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storage[,] [i]nformation transmission[,] [and] [i]nformation analysis[.]") Indeed, with the integration of digitization into almost all aspects of everyday life, often termed "digitalization," there have been numerous additional technological innovations, creating what economist Robert J. Gordon has referred to as the "Third Industrial Revolution." *See* James Alm, Joyce Beebe, Michael S. Kirsch, Omri Marian & Jay A. Soled, *New Technologies and the Evolution of Tax Compliance*, 39 VA. TAX REV. 287, 311-12 (2020). Specifically, briefly, and not exhaustively, these technological innovations driven largely by digitalization include the increasing use of or growth in such developments as electronic "cash," electronic commerce, blockchain technology, supply chains, peer-to-peer (P2P) networks, monopolization of technology sectors, "apps" and the disclosure of personal information, biometrics, "big data," and "deep learning." *Id.* Each of these developments emerges in large part from digitalization. *Id.*; Daniel McIntosh, *We Need to Talk about Data: How Digital Monopolies Arise and Why They Have Power and Influence*, 23 J. TECH. L. & POL'Y 185, 185 (2019). For a more detailed discussion of many of these developments, focusing especially on their legal aspects, see Alm, Beebe, Kirsch, Marian & Soled, *supra*, at 343–55 (2020). For related discussions about the role of technology in tax compliance, see James Alm & Jay A. Soled, *W(h)ither the Tax Gap?*, 92 WASH. L. REV. 521, 521 (2017) (explaining how technology may help eradicate tax noncompliance); Jacobs, *supra* note 16, at 26 (describing how digitalization has affected taxation).

[19] For example, the decreasing use of cash and the increasing use of digital currencies permit government tracking because digital currencies create an electronic paper trail that the government can use to trace and verify many dimensions of taxpayers' reporting decisions. *See* Gilad Edelman, *The Future of Digital Cash Is Not on the Blockchain*, WIRED (Mar. 20, 2022), https://www.wired.com/story/digital-cash-ecash-act/ [https://perma.cc/QBH9-CJS9] ("But none of these digital payment options are really like cash. Unlike paper money, they require both an internet connection and a bank account to use. Above all, they lack what has long made cash the preferred medium of civil libertarians, dissidents, and criminals alike: privacy. The only kind of money that leaves no paper trail is paper.").

[20] *See, e.g.*, Neil Savage, *Making Digital Government a Better Government*, 563 NATURE 136, 136 (2018), (discussing how digitalization can help governments deliver public services faster and more cost-effectively).

[21] There are many recent international initiatives to combat profit shifting, aggressive tax practices, and money laundering that rely upon digitalization. *See, e.g.*, Reuven S. Avi-Yonah & Haiyan Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 HARV. BUS. L. REV. 185, 187 (2016) ("On the individual tax evasion front, U.S. legislators enacted the Foreign Account Tax Compliance Act (FATCA) in 2010. This law led to the signing of Intergovernmental Agreements (IGAs) between the United States and 115 other countries (and counting) for the exchange of tax information. The IGAs led the Organization for Economic Co-operation and Development (OECD) to develop Common Reporting Standards (CRS) and the Multilateral Agreement for Administrative Assistance in Tax Matters (MAATM), which has been adopted by over eighty countries (though only signed but not ratified by the United States).").

information (often with artificial intelligence algorithms),[22] and to expand electronic filing and third-party tax information returns such as Form 1099s (e.g., reporting dividend and interest payments).[23] Such benefits reduce the ability of individuals and firms to evade or to avoid their tax obligations and thus bode well for tax collection.[24]

Congressional utilization of digitalization in the realm of tax compliance has left an indelible mark, although some taxpayer information remains outside its sphere.[25] As summarized in Subpart A, digitalization has resulted in the receipt of numerical information from third parties that the IRS can automatically cross-check. As summarized in Subpart B, there is also much information that leaves a digital trail that taxpayers self-report but that requires IRS oversight to verify. As summarized in Subpart C, taxpayers may self-report information that is void of a digital trail. Finally, Subpart D observes

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[22] *See, e.g.*, Wendell Wallach, *Rise of the Automatons*, 5 SAVANNAH L. REV. 1, 2–3 (2018) ("What deep-learning algorithms do is they can look at a massive amount of data (in fact it's required that they look at a massive amount of data) about a particular subject, and they will find significant relationships within that data. Often those are significant relationships that humans would not discover or recognize without the help of great computing power.").

[23] *See, e.g.*, I.R.S. News Release IR-2012-4 (Jan. 6, 2012) ("Overall, compliance is highest where there is third-party information reporting and/or withholding. For example, most wages and salaries are reported by employers to the IRS on Forms W-2 and are subject to withholding. As a result, a net of only 1 percent of wage and salary income was misreported. But amounts subject to little or no information reporting had a 56 percent net misreporting rate in 2006."); Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371, 372 (2007). For a recent empirical analysis of the impact of third-party reporting, see Bibek Adhikari, James Alm & Timothy F. Harris, *Information Reporting and Tax Compliance*, 110 AM. ECON. ASS'N PAPERS & PROC., 162, 163 (2020). Beyond tax return information, digitalization enables the IRS to examine other data, including taxpayers' social media. *See, e.g.*, Dara Kerr, *Tax Dodgers Beware: IRS Could Be Watching Your Social Media,* CNET (Apr. 15, 2014), http://www.cnet.com/news/tax-dodgers-beware-irs-could-be-watching-your-social-media/ [https://perma.cc/2UFZ-GJTB]; Tim Sampson, *FYI, the IRS Is Looking at Your Online Activity for Signs of Tax Evasion*, DAILY DOT (Apr. 16, 2014), http://www.dailydot.com/news/irs-social-media-tax-evasion/ [https://perma.cc/F33W-M9FL]; Jaikumar Vijayan, *IRS, DOJ Use Social Media Sites to Track Deadbeats, Criminal Activity*, COMPUTERWORLD (Mar. 16, 2010), http://www.computerworld.com/article/2516372/web-apps/irs--doj-use-social-media-sites-to-track-deadbeats--criminal-activity.html [https://perma.cc/L9GA-JSKY]; Richard Satran, *IRS High-Tech Tools Track Your Digital Footprints*, U.S. NEWS (Apr. 4, 2013), http://money.usnews.com/money/personalfinance/mutualfunds/articles/2013/04/04/irs-high-tech-tools-track-your-digital-footprints (on file with the *Ohio State Law Journal*).

[24] *See, e.g.*, Marwin Heinemann & Wojciech Stiller, *Digitalization and Cross-Border Tax Fraud: Evidence from E-Invoicing in Italy*, (CESifo, Working Paper No. 10227, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4338244#:~:text=The%20digitalization%20of%20transaction%20processes,potential%20to%20reduce%20tax%20evasion (on file with the *Ohio State Law Journal*) ("Another important aspect of digitalization is its potential to reduce tax evasion.").

[25] *See infra* Part II.A–D.

how the intersection of information with tax compliance leads to a setting ideal for questions.

A. *Information That Is Automatically Cross-Checked*

There is much evidence that tax compliance is highest when third-party tax information return reporting is robust.[26] A clear delineation of this proposition pertains to salary payments. The Code obligates employers to issue to employees Form W-2, which specifically designates their wages and, at the same time, transmits this information to the IRS.[27] As a result, when it comes to salary reporting, the voluntary compliance rate is nearly perfect (99 percent).[28] Even when taxes are not withheld, as is the case with interest income, when income is reported by third parties on Form 1099,[29] compliance rates are still extraordinarily high (generally 95 percent).[30]

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[26] *See* INTERNAL REVENUE SERV., PUBL'N 1415: FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2011–2013 (2019), https://www.irs.gov/pub/irs-pdf/p1415.pdf [https://perma.cc/84LA-XGP4]. The table below presents IRS estimates of the "Net Misreporting Percentages" (NMPs), which measure the unreported (or "misreported") income as a fraction of the estimated "true" income. *See id.* at 14 fig.3. As indicated in the table, the NMP for income that is not subject to third-party information reporting exceeds 50 percent. *Id.*

Type of Income	**Net Misreporting Percentage**	**Underreported Amount**
Subject to <u>substantial</u> information reporting <u>and</u> withholding (wages and salaries)	1%	$9B
Subject to <u>substantial</u> information reporting (pensions and annuities, unemployment compensation, dividends, interest, Social Security benefits)	5%	$12B
Subject to <u>some</u> information reporting (deductions, exemptions, partnerships and S corporation income, capital gains, alimony income)	17%	$36B
Subject to <u>little or no</u> information reporting (nonfarm proprietor income, other income, rents and royalties, farm income, Form 4797 income, adjustments)	55%	$109B

[27] *See* I.R.C. § 6051(a), (d). *See also* Richard L. Doernberg, *The Case Against Withholding*, 61 TEX. L. REV. 595, 597 (1982) ("Currently, employers file W-2 forms specifying a taxpayer's compensation . . . .").

[28] *See* Doernberg *supra* note 27, at 598.

[29] *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-21-102, BETTER COORDINATION COULD IMPROVE IRS'S USE OF THIRD-PARTY INFORMATION REPORTING TO HELP REDUCE THE TAX GAP 7 (2020) [hereinafter GAO TAX GAP REPORT] ("For items subject to

Buoyed by the success that third-party tax information returns have had on tax compliance, Congress has vastly expanded their use over time. Decades ago, beyond salary payments, Congress mandated tax information returns for reporting bank interest, company dividend payments, and broker-handled sales proceeds.[31] More recently, Congress added a requirement that, with respect to marketable securities, brokers track the tax basis of their clients' investments and add it to information returns.[32] According to the U.S. Government Accountability Office (GAO), there are 50 distinct types of information returns that are now provided by employers, businesses, health insurance providers, financial institutions, and universities, which generate various types of information on the income and income-related activities of individual taxpayers.[33] In total, there are now roughly 3.5 billion such third-party tax information returns that are annually submitted to the IRS.[34]

Once third-party tax information returns are sent to the IRS, the agency's Automated Underreporter Program (AUR) matches the information with the taxpayer's tax return and flags any inconsistencies.[35] Taxpayers with such discrepancies are sent a notice from the IRS, and underpayments are possibly subject to accuracy-related penalties.[36] Much, though not all, information reported on third-party tax information returns can be automatically cross-checked by the AUR.[37] In most cases, information is best suited for the AUR when it correlates with a specific line item on the taxpayer's tax return, such as

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substantial third-party information reporting, such as employers reporting wages on Form W-2, IRS is able to use automated processes to identify and address noncompliance.").

[30] U.S. DEPT. TREAS., THE AMERICAN FAMILIES PLAN TAX COMPLIANCE AGENDA 5 (2021), https://home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf [https://perma.cc/K35D-Z8S9].

[31] *See* I.R.C. § 6049(a) (pertaining to interest payments); I.R.C. § 6042(a) (pertaining to dividend payments); I.R.C. § 6045(a) (pertaining to returns of brokers).

[32] Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, § 403, 122 Stat. 3807, 3854–58 (codified as amended in scattered sections of 26 U.S.C.) (introducing I.R.C. Code § 6045(g), which requires that brokers track and report taxpayers' tax basis in the covered securities in which they invest).

[33] *See* GAO TAX GAP REPORT, *supra* note 29, at Preamble. ("Fifty unique types of information returns provide information on individual taxpayers and have a variety of purposes, such as reporting on wages earned or amounts paid that qualify for a tax credit or deduction.").

[34] *Id.* at 1.

[35] *Id.* at 27–28. The AUR runs after the tax-filing season has ended; and another program, the Return Review Program, automatically checks third-party information against returns to detect inconsistencies before issuing a refund to the taxpayer. *Id.* Other automated programs within the IRS use third-party information to detect nonfilers. *Id.* at 28.

[36] TREASURY INSPECTOR GEN. FOR TAX ADMIN., AUTOMATED UNDERREPORTER PROGRAM TAX ASSESSMENTS HAVE INCREASED SIGNIFICANTLY; HOWEVER, ACCURACY-RELATED PENALTIES WERE NOT ALWAYS ASSESSED WHEN WARRANTED 1–2 (2015).

[37] *See* GAO TAX GAP REPORT, *supra* note 29, at 29 ("According to IRS, AUR matches data from 27 of the 50 information returns we identified.").

employee wages reported on Form W-2.[38] This type of information, which also includes interest, dividends, pensions, and annuities, is generally subject to what the IRS calls "substantial information reporting"; and, not surprisingly, taxpayer compliance is in the 95–99 percent range in this realm.[39]

Armed with information that can be automatically cross-checked, Congress has often sought to help the IRS in the agency's quest to improve tax compliance. Third-party tax information returns enjoy the presumption of correctness, and, if taxpayers wish to dispute their accuracy, the burden of proof is only then placed on the IRS if "the taxpayer has fully cooperated with the Secretary (including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer as reasonably requested by the Secretary)."[40] Indeed, if taxpayers accidentally or intentionally fail to report the data reflected on these third-party tax information returns, they risk being subject to negligence penalties.[41]

It should be noted, however, that not all discrepancies that get flagged by the AUR are pursued by the IRS. Constraints such as paper (rather than electronic) information returns, late returns, and overall IRS budgetary limitations have negatively affected the agency's ability to use the AUR to pursue taxpayers who underreport their income.[42] Nevertheless, taxpayers' perceptions of whether the IRS will detect their noncompliance likely matter as much, if not more than, the actual rate of enforcement.[43] The fact that compliance rates for income subject to third-party information reporting is

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[38] *Id.* at 29 ("[I]nformation returns must have clear instructions for how to report on a tax return, ideally corresponding to a specific line on a tax return (complex forms and forms on which data do not match to a line on a 1040 return may not produce reliable matches)."). In recent work, Janet Holzblatt and Daniel Hemel describe this type of information as "return-specific information." *See* Daniel Hemel & Janet Holtzblatt, Can Closing the Information Gap Close the Tax Gap? 3 (Mar. 28, 2022) (unpublished manuscript) (on file with authors).

[39] *See* INTERNAL REVENUE SERV., *supra* note 26, at 20.

[40] *See* I.R.C. § 6201(d).

[41] *See* I.R.C. § 6662(a)–(b); *see, e.g.*, Moulton v. Comm'r, 97 T.C.M. (CCH) 1151 at *8 (2009) (ruling that taxpayer was subject to negligence penalty where taxpayer was issued Form W-2 reporting a settlement payment as wages and taxpayer chose to ignore it).

[42] *See* GAO TAX GAP REPORT, *supra* note 29, at 30 ("For tax year 2018, AUR identified 22.3 million cases with discrepancies and selected 2.9 million of these cases for further review by AUR examiners."). In other words, the IRS followed up on only about 13 percent of flagged returns after automatically matching third-party information returns to tax returns. *Id. See also* INTERNAL REVENUE SERV., NAT'L TAXPAYER ADVOCATE, ANNUAL REPORT TO CONGRESS, 1, *passim* (2021), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21_Full-Report.pdf (on file with the *Ohio State Law Journal*) (discussing impact of IRS budget limitations).

[43] *See, e.g.*, James Andreoni, Brian Erard & Jonathan Feinstein, *Tax Compliance*, 36 J. ECON. LITERATURE 818, 844–46 (1998) (discussing the relationship between tax compliance and taxpayers' subjective perceptions of audit detection).

high suggests that taxpayers likely assume that they will be identified and audited if they fail to accurately report such income on their tax returns.

B. *Information That Is Verifiable but Not Automatically Cross-Checked*

Not all third-party tax return information is automatically cross-checked by the AUR because it is not readily correlated with a line item on the taxpayer's return.[44] One example of such information is reporting by partnerships to their partners on Schedule K-1.[45] While taxpayers report their share of taxable partnership income, the Schedule K-1 information cannot easily be verified through an automated process due in part to the complexity of partnership tax reporting.[46]

Some other types of verifiable information come from sources other than third-party tax information returns. For example, until recently, alimony payments were deductible by payers and their receipt was includable by recipients.[47] To augment tax compliance, Congress mandated that alimony payers report the tax payer identification numbers of alimony recipients on their tax returns.[48] Utilization of this methodology was not foolproof: a report released by the Treasury Inspector General for Tax Administration (TIGTA) found that many alimony recipients were not reporting the payments that they received as income.[49] Nevertheless, there is little doubt that, had the IRS not had this information, compliance would have proven even more problematic.[50]

[44] *See* GAO TAX GAP REPORT, *supra* note 29, at 29. Hemel and Holtzblatt refer to such information as "return-relevant information." *See* Hemel & Holtzblatt, *supra* note 38, at 3.

[45] U.S. GOV'T ACCOUNTABILITY OFF., GAO 14-453, PARTNERSHIPS AND S CORPORATIONS: IRS NEEDS TO IMPROVE INFORMATION TO ADDRESS TAX NONCOMPLIANCE 8–9 (May 2014)., https://www.gao.gov/assets/gao-14-453.pdf [https://perma.cc/KM2Z-67KP].

[46] *See id.* ("K-1 matching of individual returns is not designed to detect misreporting about business operations at the flow-through entity level. Additionally, it does not match partnership and S corporation returns with the K-1s they receive from other flow-through entities.").

[47] *See* prior I.R.C. § 71(a) (repealed 2017) (alimony deemed taxable income); prior I.R.C. § 215(a) (repealed 2017) (alimony deemed deductible).

[48] *See* I.R.C. § 215(c)(2).

[49] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., SIGNIFICANT DISCREPANCIES EXIST BETWEEN ALIMONY DEDUCTIONS CLAIMED BY PAYERS AND INCOME REPORTED BY RECIPIENTS 4 (Mar. 2014), https://www.treasury.gov/tigta/auditreports/2014reports/201440022fr.pdf [https://perma.cc/E8PE-N9E5]; Tessa R. Davis, *A Human Capital Theory of Alimony and Tax*, 25 GEO. MASON L. REV. 352, 354–55 (2018) ("The study, conducted by the Treasury Inspector General for Tax Administration ("TIGTA") discovered that, in the tax year studied, noncompliance with section 71 resulted in $2.3 billion in alimony deductions for which there was no corresponding income inclusion by the recipient. Of the more than half-million returns claiming an alimony deduction in the taxable year studied, 47 percent had a deduction/inclusion mismatch. The study also found systemic problems with the

The IRS describes partnership, alimony, and similar income categories as subject to "some information reporting" but acknowledges that it is the kind of information that is not automatically verifiable.[51] Such income has a compliance rate of approximately 83 percent, which is lower than income subject to "substantial" information reporting (95 percent) but still much better than compliance when no information reporting is present (less than 50 percent).[52] This result is intuitive: we would expect taxpayers to be less forthright if they think that they are not subject to automatic cross-checking, but we would still expect higher compliance overall when an IRS audit could easily reveal underreporting due to verifiable information from third parties and other sources, such as social security numbers.

C. *Information Received That is Not Cross-Checked or Easily Verified*

Finally, some tax return information is neither matched by IRS computers nor subject to verifiable third-party information. Accordingly, the IRS describes this income as being subject to "little or no" third-party tax information reporting, a category the scope of which includes sole proprietor income, rents, royalties, and farm income.[53] A classic example of such income would be a sole proprietor, say, a painter, who only takes payments in cash. The IRS could, of course, conduct an audit and suggest, based on the taxpayer's lifestyle and overall consumption, that the taxpayer's business income had been underreported. However, this would be a more labor-intensive and uncertain process as compared to the process when verifiable third-party tax information is accessible. Taxpayers no doubt understand this. Thus, in the absence of third-party tax information reporting, an honor system of sorts exists, and the adjective "honor" may be a misnomer: according to the IRS, in these circumstances, taxpayer compliance hovers around 45 percent, meaning that more than half of such income goes unreported.[54]

Service's procedures for identifying and addressing the "alimony reporting compliance gap" as well as repeated failures by the Service to assess applicable penalties for failing to identify the alimony recipient.").

[50] When it comes to asset sales, the IRS endorses the same sort of cross-checking strategy utilizing Form 8594 (Asset Acquisition Statement). Via this form, both the buyer and seller to a transaction must allocate a portion of the purchase price to different asset classes and submit consistent forms. Treas. Reg. § 1.1060-1(e)(1)(i).

[51] *See* INTERNAL REVENUE SERV., *supra* note 26, at 20; *see also* GAO TAX GAP REPORT, *supra* note 29, at 29. *See also* Viswanathan, *supra* note 4, at 289 ("For sources of income subject to only some information reporting, including income from partnerships, S-corporations, trust and estate allocations, alimony payments, and capital gains, the net misreporting percentage increases to 19% . . . .).

[52] INTERNAL REVENUE SERV., *supra* note 26, at 20.

[53] *Id.*

[54] *Id.*

D. *Information, Tax Compliance, and the Role of Questions*

One critical takeaway from the foregoing discussion is the importance of information and its placement in IRS hands. Admittedly, sometimes the collection, processing, and distillation of information by both taxpayers and the IRS can be a labor- and resource-intensive task, and thus its extraction should be done with some care. Indeed, the IRS should never seek to collect taxpayer information with no specific purpose or goal in mind or with little chance of enhancing taxpayer compliance. However, if particular information provides strategic advantages to the IRS in ways that will enhance taxpayer compliance, then the agency should capitalize upon such opportunities.

The role of questions populating tax returns is thus obvious. Such questions can help level the information playing field and provide a far better picture to the IRS of the taxpayer circumstances at hand. The more probing the question, the greater its utility. Admittedly, in responding to such questions, taxpayers can lie, but, as explored further below,[55] acts of commission are far more mentally challenging than acts of omission. And, as the aforementioned compliance statistics demonstrate, the receipt of information generally tilts the deck in the IRS's favor and helps enhance taxpayer compliance.

III. STRATEGIC USE OF QUESTIONS

There is no written history regarding the origin of "questions."[56] However, one can readily imagine that from the time in which spoken language emerged, the act of posing questions was a commonplace verbal phenomenon among humans.[57] After all, humans had to find shelter, they had to locate food supplies, they had to clothe themselves, and they had to interact with others in these and other activities.[58] Questions were no doubt an efficient way by which humans could learn from each other and function more adeptly.[59]

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[55] *See infra* Part III.A.

[56] The Wikipedia site on the topic of "Question" fails to provide a historical overview of questions. *Question,* WIKIPEDIA, https://en.wikipedia.org/wiki/Question [https://perma.cc/DB6S-R7LV]. In Merriam-Webster Dictionary, the etymology of question is "[m]iddle English, from Anglo-French, from Latin question-, quaestio, from quaerere to seek, ask." *Question,* MERRIAM WEBSTER, https://www.merriam-webster.com/dictionary/question#word-history [https://perma.cc/BUA9-YY3Q]. *See also* Malick Ghachem, *The Question of La Question*, 15 YALE J. L. & HUMAN.'S 179, 180 n. 5 (2003) ("[Question] derives from the Latin *quaestio*, which in Roman law signified an interrogation or inquiry.").

[57] *See* Michael Balter, *Human Language May Have Evolved to Help Our Ancestors Make Tools*, SCIENCE, (Jan. 13, 2015) https://www.science.org/content/article/human-language-may-have-evolved-help-our-ancestors-make-tools [https://perma.cc/Y8RP-TN8K]

[58] *Id.*

[59] In all likelihood, question popularity was probably made vogue thousands of years ago by organized religion. Consider the fact that punctuating the Old Testament is a

Over the last several decades, social science research has explored the impact that questions have on human behavior.[60] Subpart A summarizes general research in this sphere, including how questions that require an affirmative response can invoke the so-called omission bias, and then examines its application to tax compliance. Subpart B discusses two important historical case studies that illustrate the potential for questions that solicit verifiable information to improve tax compliance.

A. *Formulating Questions Based upon Social Science Research*

Social science research has contributed to our wealth of understanding about many of the salient characteristics of the human condition—those experiences that have the propensity to bring us joy, happiness, grief, empathy, and so on. The list is extensive, and, as these research endeavors continue, they educate us as to those public policy measures, typically referred to as "nudges," that can effectively influence behavior in ways that are productive and beneficial to society.[61]

plethora of thought-provoking questions. *See, e.g.*, *Genesis* 3:9 ("Where are you?"); *Genesis* 4:9 ("Am I my brother's keeper?"); *Genesis* 18:25 ("Shall not the judge of all the earth do right?"). The New Testament carries on this theological tradition with Jesus making important inquiries. *See, e.g.*, *Matthew* 16:15 ("Who do you say I am?"); *Mark* 8:36 ("What good is it for someone to gain the whole world, yet forfeit their soul?"). Other religious traditions have followed this same time-honored custom of paying appropriate homage to the importance of questions. For example, Confucius is renowned for raising the following central life questions: (i) What is the right way to rule? and (ii) What is the right way to live? *See Big Thinkers: Confucius*, ETHICS CTR. (May 21, 2018), https://ethics.org.au/big-thinker-confucius/ [https://perma.cc/6QQZ-KS3P]. Another catalyst likely propelling question use may have been various philosophical schools of thought. This is perhaps best epitomized by the Platonic dialogues authored by Plato about his friend and mentor, Socrates, in which the power of questions is exemplified. *See generally* PLATO, FIVE DIALOGUES (G. M. A. Grube & J. M. Cooper trans., Hackett Publ'g Co., 2d ed., 2002). Other philosophers have modeled their didactic approach after Plato, often relying upon the power of questions to help educate their listeners. *See, e.g.*, Adrian F. Ward, *Scientists Probe Human Nature—and Discover We Are Good, After All*, SCI. AM. (Nov. 20, 2012), https://www.scientificamerican.com/article/scientists-probe-human-nature-and-discover-we-are-good-after-all/ [https://perma.cc/P3R2-PW4A] (describing various strands of social science research and the conclusions drawn regarding the human condition).

[60] *See infra* Part III.A–B.

[61] *See generally* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS, 3–4 (2008) (describing various so-called choice architectures that are designed to alter people's behavior). *But see*, Nick Chater & George Loewenstein, *The I-Frame and the S-Frame: How Focusing on Individual-Level Solutions Has Led Behavioral Public Policy Astray*, BEHAVIORAL & BRAIN SCIENCES (2022), https://www.cambridge.org/core/journals/behavioral-and-brain-sciences/article/abs/iframe-and-the-sframe-how-focusing-on-individuallevel-solutions-has-led-behavioral-public-policy-astray/A799C9C57F388A712BE5A8D34D5229A1 (on file with the *Ohio State Law Journal*) (questioning the effectiveness of nudges).

In the realm of taxation, social science research has much to offer in terms of helping foster taxpayer compliance. Scholars have documented numerous potential behavioral interventions to reduce tax evasion, such as sending letters that appeal to social norms, allowing taxpayers to direct how their tax dollars are spent, and reminding taxpayers of the penalties for evading.[62] This Article focuses on one area of the social science literature that has been less explored in the domain of tax compliance: the distinction between omissions versus commissions.[63] Social science research shows that individuals respond differently to acts of dishonesty (or other unethical behavior) depending on whether an act is an omission (that is, the failure to do something) or a commission (that is, an affirmative act).[64] Importantly, this research demonstrates that individuals tend to view omissions as less unethical and more consistent with their positive views of themselves, whereas they tend to view commissions as more unethical and subject to a higher risk of punishment.[65] This distinction is particularly relevant to tax returns because the nation's current system of self-reporting unintentionally allows individuals to cheat through omission by simply failing to report income or other pertinent information.[66]

Before turning to the specific tax compliance problems that result from acts of omission, the sections below review the social science literature on this topic. Section 1 explores the human tendency to favor acts of omission versus those of commission; Section 2 documents research on the cognitive factors that support this bias; Section 3 summarizes the strategic use of omissions designed to avoid those punishments commonly associated with acts of

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[62] *See, e.g.*, Kathleen DeLaney Thomas, *The Psychic Cost of Tax Evasion*, 56 B.C. L. REV. 617, 619–21, 643 (2015) (proposing interventions to make the psychological cost of cheating higher); STEPHEN COLEMAN, MINN. DEPT. REVENUE, THE MINNESOTA INCOME TAX COMPLIANCE EXPERIMENT STATE TAX RESULTS 5–6, 18-19 (1996) https://www.revenue.state.mn.us/sites/default/files/2011-11/research_reports_content_complnce.pdf [https://perma.cc/5XPH-UDKC] (testing the impact of letters appealing to social norms); Joel Slemrod, Marsha Blumenthal & Charles Christian, *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota*, 79 J. PUB. ECON. 455, 456 (2001); Yair Listokin & David M. Schizer, *I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179, 179–80 (2013) (arguing that taxpayers will better comply if they support the way their tax dollars are spent); Justin E. Holz, John A. List, Alejandro Zentner, Marvin Cardoza & Joaquin Zentner, *The $100 Million Nudge: Increasing Tax Compliance of Businesses and the Self-Employed Using a Natural Field Experiment* 3 (Becker Friedman Inst., Working Paper No. 2020-113, 2020), https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_2020113.pdf [https://perma.cc/5CKB-3RH7] (sending notices that made salient potential prison sentences for evasion increased compliance).

[63] *See* Bankman, Nass & Slemrod, *supra* note 3, at 465–66, 469.

[64] *See infra* Part III.A.1.

[65] *See infra* Part III.A.1.

[66] *See, e.g.*, INTERNAL REVENUE SERV., *supra* note 26, at 20.

commission; and, finally, Section 4 details the results of several recent studies that demonstrate the gravitational pull that omissions have in shaping tax-reporting behavior.

1. *The Omission Bias*

Psychologists have documented a tendency for individuals to view acts of commission as "more morally reprehensible" than acts of omission.[67] This appears to reflect a belief that acts of commission involve malicious motives, while acts of omission may not,[68] perhaps because omissions are more likely to be unintentional.[69] Researchers have termed these beliefs the "omission bias."[70] The bias refers to the fact that individuals may judge acts of omission as more innocuous than acts of commission even when both are intentional and when they both result in equivalent harm being perpetrated.[71]

For example, when study subjects are presented with fictional scenarios that involve equivalent harm to another person that happens through either omission or commission, they tend to rate those participating in the omission scenarios as being less culpable.[72] In one study involving a scenario where a hypothetical person named John hoped his tennis opponent, Ivan, would get sick by eating something to which he was allergic, study subjects thought it was less nefarious when John simply did not warn Ivan that he was about to eat the harmful food, as compared to a scenario where John recommended that Ivan eat the harmful food.[73] In both scenarios, John had knowledge of the harmful food and the intention that Ivan would get sick and not be able to play well in his tennis match.[74] Regardless, most participants indicated that making the recommendation was worse, with many also believing that John played a greater causal role in Ivan's sickness in the commission scenario compared to the (knowing) omission scenario.[75]

The fact that individuals perceive acts of omission as being more ethical (or less unethical) than acts of commission has significant implications for tax compliance because tax evasion often results from acts of omission.[76] Thus, taxpayers may view themselves as less blameworthy if they fail to report

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[67] *See* Nina Mazar & Scott A. Hawkins, *Choice Architecture in Conflicts of Interest: Defaults as Physical and Psychological Barriers to (Dis)honesty*, 59 J. EXPERIMENTAL SOC. PSYCH. 113, 113 (2015).

[68] *Id.*

[69] *See* Spranca, Minsk & Baron, *supra* note 11, at 76.

[70] *Id.* at 78–79.

[71] *Id.*

[72] *Id.* at 87.

[73] *Id.* at 82–87.

[74] *Id.* at 82–86.

[75] Spranca, Minsk & Baron *supra* note 11, at 85.

[76] *See infra* Part III.A.3.

income because such a failure does not constitute an affirmative act.[77] The next section explores the underlying psychological mechanisms that make acts of commission feel more heinous than acts of omission.

2. *Cognitive Factors Favoring Acts of Omission*

There are several well-documented cognitive factors that contribute to the human bias favoring acts of omission over acts of commission. Such factors include (a) cognitive miserliness and (b) impression management combined with behavior categorization.[78] Understanding these phenomena sheds light on why taxpayers are likely to have an easier time committing acts of omission as compared to acts of commission.

a. *Cognitive Miserliness*

As a matter of general physiology, humans tend to do whatever it takes to preserve their energy, referred to as "cognitive miserliness."[79] This proclivity probably harkens back to our hunter-gatherer biological selves, when we never knew when and from where our next meal would come or whether we would suddenly find ourselves in need of shelter.[80] A simple mechanism to achieve our innate energy preservation objective would be to avoid the commission of lying.

Modern technology, which can trace blood flow and electrical waves traveling within one's body, shows that actively lying is cognitively

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[77] *See id.*

[78] *See infra* Part III.A.2.a–b.

[79] *See* Aditi Mehra, *9 Signs You May Be A Cognitive Miser*, PSYCH. TODAY (Feb. 27, 2019), https://www.psychologytoday.com/us/blog/cognitive-learning-and-skill-deficits/201902/9-signs-you-may-be-cognitive-miser [https://perma.cc/H5Q3-CJV6] ("What on earth is a cognitive miser? . . . It's a term coined by Susan Fiske and Shelley Taylor, . . . described as: the brain's tendency to seek solutions to problems that take the least mental effort . . . . We have all formed habits that enable us to virtually bypass the thinking process. We've hardwired our brains to take shortcuts."); Keith E. Stanovich, *Miserliness in Human Cognition: The Interaction of Detection, Override and Mindware*, 24 THINKING & REASONING 423, 423 (2018), https://www.tandfonline.com/doi/abs/10.1080/13546783.2018.1459314 [https://perma.cc/TGY2-4PKZ] ("Humans are cognitive misers because their basic tendency is to default to processing mechanisms of low computational expense.").

[80] *See* Colby Itkowitz, *This Harvard Professor Explains Why We Were Born to Resist Working Out*, WASH. POST (Sept. 15, 2016), https://www.washingtonpost.com/news/inspired-life/wp/2016/09/15/this-harvard-professor-knows-why-you-skipped-the-gym-this-morning-it-is-natural-and-normal-to-be-physically-lazy/ [https://perma.cc/U9E9-7XBG] ("[O]ne Harvard professor . . . believes our ancestors exerted so much energy hunting and gathering that they sought rest whenever they could. We are predisposed to want to conserve energy.").

enervating, something that the human brain prefers to avoid whenever possible.[81] Evidence for this proposition can readily be found in how polygraphs, so-called lie detector tests, operate. Individuals participating under the scrutiny of a lie-detecting test are connected to a machine that measures "respiration, heart rate, perspiration, and blood pressure."[82] When participants reply to questions with truthful responses, their bodily activities are generally minimal; by comparison, when participants actively lie while responding to questions, "the fear of being detected causes increased activation of their sympathetic nervous system [and] [t]his activation leads to an increase in heart rate, blood pressure, respiration, and perspiration."[83]

Beyond lie detector tests, social scientists have also undertaken a series of studies that demonstrate that humans tend to be cognitive misers, intent on conserving our brain's energy and power whenever possible.[84]

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[81] *See, e.g.*, Anil Ananthaswamy, *The More You Lie, the Easier It Gets*, NEWSCIENTIST (Feb. 8, 2011), https://www.newscientist.com/article/dn20085-the-more-you-lie-the-easier-it-gets [https://perma.cc/TN25-9QRM] ("Neuroimaging studies have shown that people's brains show considerably more activity when they are lying than when they are not, particularly in the prefrontal cortex, suggesting that lying requires extra cognitive control and inhibition of truth-telling."); Avery Elizabeth Hurt, *Lying Won't Stretch Your Nose, but It Will Steal Some Brainpower*, SCI. NEWS EXPLORES (Apr. 21, 2022), https://www.snexplores.org/article/lying-brain-power-prefrontal-cortex-truth-telling [https://perma.cc/TZA2-7UKD] ("But no matter what kind of lie you tell, it takes a surprising amount of brainpower to pull it off."); Bill Sullivan, *The Truth About Lying and What It does to the Body*, PSYCH. TODAY (Jan. 5, 2020), https://www.psychologytoday.com/us/blog/pleased-meet-me/202001/the-truth-about-lying-and-what-it-does-the-body [https://perma.cc/9UZ7-3R9V] ("Dishonesty puts the brain in a state of heightened alert, and this stress increases with the magnitude of the lie.");.

[82] *See, e.g.*, Christian L. Hart, *Do Lie Detector Tests Really Work*, PSYCH. TODAY (Jan. 14, 2020), https://www.psychologytoday.com/us/blog/the-nature-deception/202001/do-lie-detector-tests-really-work [https://perma.cc/6AWF-NMKB] ("[T]he modern polygraph is now an integrated, state-of-the-art, computerized system that continuously monitors blood pressure, heart rate, respiration, and perspiration.").

[83] *Id*.

[84] *See* Xiaoqing Hu, Hao Chen & Genyue Fu, *A Repeated Lie Becomes a Truth? The Effect of Intentional Control and Training on Deception*, 3 FRONTIERS PSYCH. 4-5 (2012) ("Evidence from neuroimaging studies also demonstrated that when people generate deceptive responses in [tasks that engender lying], the brain regions associated with cognitive control and conflict monitoring processes were more active than when participants give honest responses."). In one recent experiment, neurologists used a computer screen in which two dots would appear on the screen, creating the illusion of motion. UNIV. OF GLASGOW, *Remembering the Future: Our Brain Saves Energy by Predicting What it Will See,* MEDICAL XPRESS (Mar. 24, 2010) https://medicalxpress.com/news/2010-03-future-brain-energy.html [https://perma.cc/439R-VGAS]. They then added a third dot on the screen that in one case would sync with the motion and, in the other case, would be out of sync. *Id*. What the neurologists discovered is that the human brain seeks to conserve its energy. *Id*. How? The experiment demonstrated that individuals responded by predicting what they thought they were likely to see—namely, the dots arranged in a synced fashion—rather than by grappling with the out-of-

b. *Impression Management and Behavior Categorization*

As a general proposition, people want to project a positive image of themselves to fellow members of the community.[85] Doing so better enables them to weave themselves into the community's social fabric, facilitating and fostering interpersonal and business relationships. To achieve this objective, a common technique is known as impression management or "efforts by an actor to create, maintain, protect or otherwise alter an image held by a target audience."[86] Impression management involves several different kinds of tactics, including, but not limited to, being ingratiating, supplicating, and offering justifications.[87] It is a common practice on social media platforms.[88]

What does impression management have to do with tax return practices? Presumably, if possible, taxpayers would like to be tax compliant, reducing their odds of experiencing a tax audit or putting themselves in financial jeopardy. A paramount goal for many taxpayers is to project to others in their "community" that they play by the rules and are not tax cheats.[89] By projecting a positive self-image, they also wish to minimize any "cognitive dissonance"[90] —the discomfort a person feels when their behavior does not align with their values or beliefs—that they might otherwise experience were they to overtly cheat on their taxes while still believing that they are honest and law abiding individuals.[91]

Notwithstanding the dual goals of impression management coupled with minimizing cognitive dissonance, many taxpayers are still not forthcoming in their tax return reporting practices.[92] The question is why. This is when "behavior categorizations" (or rationalizations) take center stage. Behavior

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sync motion. *Id*. ("Researchers have discovered that the brain saves energy by predicting what it is likely to see.").

[85] *See, e.g.*, Kathryn M. Stanchi, *The Science of Persuasion: An Initial Exploration*, 2006 MICH. ST. L. REV. 411, 420 (2006) ("People will make decisions that protect and affirm their positive images of themselves.").

[86] Mark C. Bolino, K. Michele Kacmar, William H. Turnley, & J. Bruce Gilstrap, *A Multi-Level Review of Impression Management Motives and Behaviors*, 34 J. MGMT. 1080, 1080 (2008).

[87] *Id.* at 1082.

[88] Liam Bullingham & Ana C. Vasconcelos, '*The Presentation of Self in the Online World': Goffman and the Study of Online Identities*, 39 J. INFO. SCI. 101, 102–103 (2013).

[89] *See e.g.*, Bolino, Kacmar, Turnley, & Gilstrap, *supra* note 86.

[90] *See* Saul McLeod, *What Is Cognitive Dissonance*, SIMPLY PSYCH. (June 15, 2023), https://www.simplypsychology.org/cognitive-dissonance.html [https://perma.cc/4PZQ-KTMS] ("Cognitive dissonance refers to a situation involving conflicting attitudes, beliefs or behaviors. This produces a feeling of mental discomfort leading to an alteration in one of the attitudes, beliefs or behaviors to reduce the discomfort and restore balance.").

[91] *See id.* ("Festinger's (1957) cognitive dissonance theory suggests that we have an inner drive to hold all our attitudes and behavior in harmony and avoid disharmony (or dissonance). This is known as the principle of cognitive consistency.").

[92] *See e.g.*, INTERNAL REVENUE SERV., *supra* note 26, at 20.

categorizations are practices by which individuals label their actions in ways that enable them to maintain their positive self-conception.[93] For example, while an employee who thinks of himself as honest might not take petty cash directly from his employer, he might be willing to take the equivalent dollar amount in office supplies like paper and pens, rationalizing that his employer might want him to work at home and the office supplies would help him to be prepared (even if that day never comes). The key takeaway here is that individuals are adept at coming up with rationalizations to support their desired behavior, even when such behavior might seem at odds with their personal self-concept of themselves as virtuous.[94]

When it comes to taxes, taxpayers' rationalizations for noncompliance abound.[95] Examples of such rationalizations may be along the lines of the following statements:

> "If the government wanted this income to be reported, I would have gotten a 1099."
>
> "The trip to Paris for an important one-day business meeting is the true catalyst that brought me overseas, not the two-week European adventure that followed."
>
> "The down payment that I am contributing to enable my daughter to purchase her first house is not really a taxable gift because she is in desperate need of funding."

As in many other areas of behavior, taxpayers can often create a narrative that allows them to do what they want (pay less tax) while maintaining a positive self-image.

Overall, research on cognitive miserliness, image management, and cognitive dissonance combined with behavior categorization sheds light on why cheating through omission is psychologically easier than cheating through

[93] *See, e.g.*, Thomas, *supra* note 62, at 635 ("Studies reveal, however, that individuals tend to adopt strategies to 'categorize' dishonest behavior as something other than cheating. Categorization is the process by which an individual constructs an internal narrative that allows him to view his behavior as consistent with his self-concept.").

[94] *See id.*; *see also* McLeod, *supra* note 90.

[95] Leandra Lederman has grouped taxpayer rationalizations into the following three categories: "(1) *self help* (creating one's own tax break); (2) *an eye for an eye* (a response to perceived governmental misspending or other inadequacies); and (3) *refusal to be a chump* (because cheaters are routinely not caught, the compliant pay more than everyone else)." Leandra Lederman, *The Fraud Triangle and Tax Evasion*, 106 IOWA L. REV. 1153, 1192 (2021) (emphasis in original). *See generally* James A. Tackett, Joe Antenucci & Fran Wolf, *A Criminological Perspective of Tax Evasion*, 110 TAX NOTES 654, 655-56 (2006) (explaining the role of rationalizations in tax evaders' mindsets).

an act of commission: omissions require less mental effort and are often easier to rationalize in a way that neither subverts the positive image taxpayers wish to project nor stirs cognitive dissonance that needs to be addressed.

3. *Omission As a Rational Strategy*

As discussed above, psychologists have documented numerous ways in which individuals perceive omissions to be different from commissions even when there may be no difference in intent or outcome. Sometimes this appears to reflect irrational thinking (that is, cognitive bias), but in other contexts it may be perfectly rational to view commissions as being more unethical than omissions. For example, the law may criminalize an act of commission (such as physical assault) and not criminalize an omission with a similar result (such as failure to intervene in an assault).[96]

In the context of tax compliance, both omissions and commissions subject taxpayers to punishment.[97] For example, Code section 7201 makes it a felony to "willfully attempt *in any manner* to evade or defeat any tax" (emphasis added); this could apply both to taxpayers who willfully report false information on a tax return and to taxpayers who willfully omit accurate information to reduce their tax bill.[98] Similarly, the tax law contains civil penalties that apply both to taxpayers who report false information (for example, overstating the value of an asset to increase a deduction) and to taxpayers who lie through omission (for example, understating income to

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[96] *See* Spranca, Minsk & Baron, *supra* note 11, at 77 ("Very few states and nations even have 'Bad Samaritan' laws by which a person may be prosecuted for failing to help someone else in need."). Consider a game experiment study conducted by Peter DeScioli, John Christner, and Robert Kurzban published in *Psychological Science*. Peter DeScioli, John Christner & Robert Kurzban, *The Omission Strategy*, 22 PSYCH. SCI. 442, 443–45 (2011). As part of the study, a "taker participant" could draw money away from an "owner participant" either by commission (actively choosing to lay hold of a portion of the owner's money) or omission (letting a timer run out, which automatically resulted in a sum being allocated to the taker participant albeit a smaller sum than with commission). *Id*. at 443. The payoff structure for takers and owners was such that taking the money through an act of commission resulted in a better outcome for both sides. *See id*. The study also manipulated in some treatments whether a third party (a "punisher participant") had the opportunity of punishing the taker by reducing the taker's payment. Overall, the authors found that people generally chose omissions over commissions (despite the payoff superiority of commissions). The authors also found that the frequency of omissions increased when punishment was possible. *Id.* at 443–44. A subsequent questionnaire revealed that most people thought that the omission was "less wrong" and less likely to be punished than a commission. *Id*. at 444. Thus, the authors concluded "that the preference for omission is strategic: People choose omissions to avoid third-party condemnation and punishment." *Id.*

[97] *See* I.R.C. § 7201.

[98] *Id.*

reduce tax owed).[99] However, when it comes to taxpayers' decisions, it is their perceptions of punishment and, in particular, its certainty rather than necessarily its severity that matter for their behavioral choices.[100] Thus, if taxpayers perceive that they are more likely to face a sanction and one which is more severe for reporting inaccurate information on a return as compared to omitting such information, then they are more likely to favor the latter behavior.

In addition, taxpayers might not always be wrong when they perceive omissions to be a more desirable strategy to avoid punishment. In certain circumstances, taxpayers can avoid the imposition of civil tax penalties altogether by showing that they had reasonable cause for their inaccurate reporting and that they acted in good faith.[101] Whether this reasonable cause and good faith exception applies depends on the facts and circumstances of the particular case, but a crucial component is whether the taxpayer can demonstrate that she made an honest mistake, given her level of knowledge, education, and experience.[102] It is surely easier to meet this good faith standard in the case of omitted items because a taxpayer might credibly claim that she forgot to report something or honestly did not know that she had to report it. It is far harder for a taxpayer to argue the same if she provided false information on her tax return. Taxpayers may thus find it hard to avoid the imposition of civil penalties for acts of commission.[103]

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[99] *See, e.g.*, I.R.C. §§ 6662(b)(2) (substantial understatement of income tax), 6662(b)(3) (substantial valuation misstatement).

[100] *See,* Tina Wescott Cafaro, *You Drink, You Drive, Your Lose: Or Do You*?, 42 GONZ. L. REV. 1, 8 (2006-2007) ("Traditional criminal law deterrence theory asserts that an individual's perception of the punishment meted out for engaging in a particular behavior has a substantial impact on deterring that individual's conduct."); NICHOLAS N. KITTRIE & ELYCE H. ZENOFF, SANCTIONS, SENTENCING, AND CORRECTIONS 15 (1981) ("[S]ociety hopes to deter wrongdoing by posing specific punishments . . . with the expectation that the punishment will have a double effect: both convincing the lawbreaker not to repeat his transgression and, at the same time, serving as a 'cautionary tale,' a warning deterrent to other members of society."). *See also* United States v. Luna-Jasso, No. CR 14-3523 JB, 2015 WL 1006390, at *17 (D.N.M. Feb. 19, 2015) (documenting numerous empirical studies which demonstrate that certainty of punishment rather than its severity has significant behavioral changes).

[101] *See* I.R.C. § 6664(c)(1) (reasonable cause and good faith exception to accuracy-related penalties under section 6662).

[102] *See* Treas. Reg. § 1.6664–4(b) (2007).

[103] Consider the fact that both civil and criminal tax penalties generally require that the IRS prove that the taxpayer acted willfully. *See, e.g.*, I.R.C. §§ 7201 (willful attempt to defeat or evade tax), 7202 (willful failure to collect or pay tax), 7203 (willful failure to file a return); *see also* I.R.C. § 6663 (civil fraud). According to the IRS, "[c]ivil fraud penalties will be asserted when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to fraud. Such evidence must show the taxpayer's intent to evade the assessment of tax, which the taxpayer believed to be owing." IRM 25.1.6.2(3) (June 10, 2021). Although such penalties can thus technically apply to both omissions and commissions, the IRS generally will have an easier time meeting its burden of proof when

4. *Evidence That the Omission-Versus-Commission Distinction Affects Tax Compliance*

Two recent studies, one from the United Kingdom and another from the Dominican Republic, aptly demonstrate that the omission-versus-commission distinction affects individuals' decision-making in ways that are relevant to tax compliance.[104]

In the United Kingdom, researchers collaborated with the government in a field experiment involving individuals who had been accidentally overpaid tax credits by the government.[105] As a practical matter, failing to repay the excess credit was an omission.[106] Working in conjunction with the government, researchers sought to encourage payment from delinquent taxpayers by

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a taxpayer has engaged in acts of commission. *See supra* notes 103–05 and accompanying text. Proving fraud generally requires circumstantial evidence of the taxpayer's state of mind. *See* IRM 25.1.6.4(1) (June 10, 2021). Although omissions can be a form of evidence (particularly if the omission is significant, such as not reporting an entire cash-based business), many of the so-called badges of fraud that the IRS invokes involve affirmative acts. *See* IRM 25.1.6.4(2) (June 10, 2021). For example, the Internal Revenue lists, as examples, the following badges of fraud: fictitious deductions, accounting irregularities such as two sets of books, false statements, destroying records, and dealing in cash. *Id.* Taxpayers may thus rationally perceive that they are more likely to be subject to criminal penalties if they lie through commission as compared to omission.

[104] There was also an experimental study that reached this same conclusion. In the study, participants were given prepopulated tax returns to examine. Wilco van Dijk, Sjoerd Goslinga, Bart Terwel & Eric van Dijk, *How Choice Architecture Can Promote and Undermine Tax Compliance*, 87 J. BEHAV. & EXPERIMENTAL ECON. 1, 2–3 (2020). The study's subjects had a financial incentive to cheat because their reported liability from the tax return was to be subtracted from their compensation for participating in the study. *Id.* at 3. In some cases, the default dollar amounts populating the hypothetical tax return were incorrect in ways that favored the participant, while in other cases the default amounts were incorrect in ways that were unfavorable to the participants. *Id*. The study's results revealed several findings. Not surprisingly, there was more cheating when the return was incorrectly prepopulated in a favorable way—allowing subjects to cheat through omission. *Id.* at 6. Interestingly, however, some subjects also failed to fix incorrectly prepopulated returns that were not favorable, suggesting a powerful default effect. *Id.* at 5. In other words, participants were particularly unmotivated to override defaults. This "status quo bias" has been confirmed in numerous other psychological studies. *Id.* at 2, n. 1 *See, e.g.*, Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSP. 193, 194 (1991) (affirming the existence of status quo bias). In sum, the authors of the prepopulated tax return study found that a mixture of status quo bias (that is, adherence to defaults) and omission bias contributed to the result that subjects cheat more when returns are incorrectly prepopulated. Goslinga, Terwel & Van Dijk, *supra* at 6.

[105] *See* Michael Hallsworth, John A. List, Robert Metcalfe & Ivo Vlaev, *The Making of Homo Honoratus: From Omission to Commission* 3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 21210, 2015).

[106] *Id.* at 3.

reframing their failure to repay as a commission.[107] To that end, a group of taxpayers received a letter from the government stating, "Previously, we treated your lack of response as an oversight. Now, if you do not call [telephone number], we will treat this as an active choice."[108] Another group got a standard repayment notice that did not mention active choice.[109]

The results were striking: The individuals who received the experimental letter repaid at a rate almost twice that of the controls—23 percent compared to 12 percent—leading to an additional $1.8 million of tax revenue collected from the notices.[110] To better understand why more people would pay the amount owed after receiving the "omission to commission" letter, the researchers followed up with a survey, which found that "80 percent of people believe that non-payment in the omission to commission treatment will result in greater punishment compared to non-payment in the control treatment."[111] Thus, the researchers concluded that the increased compliance in the experiment was likely attributable to a belief that there would be greater punishment from failure to pay when such failure was framed as an act of commission.[112]

In the Dominican Republic, researchers partnered with government officials to send various reminder messages to businesses (both self-employed individuals and firms) about their tax obligations.[113] Controls received a standard reminder of the tax deadline, while two experimental groups received the reminder message with additional language highlighting that tax evasion might either result in a prison sentence and/or be made public.[114] Additionally, half of the subjects in all groups also received a "commission frame" message informing the taxpayer that providing "inaccurate information in the tax return might not be considered as an oversight, but as a voluntary choice, which would represent a violation of your obligations."[115] Among the participants, the commission frame had an enormous impact among subjects who also received the message highlighting the potential for a prison sentence, doubling its impact relative to those not receiving the commission frame.[116]

The implications of these two studies for tax compliance are obvious and significant. As tax returns are currently designed, reporting accurate information requires an affirmative act.[117] On the other hand, omitting relevant information can be easily accomplished by simply leaving line items (or tax

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107 *Id.* at 2.
108 *Id.* at 3.
109 *Id.* at 5.
110 *Id.* at 3.
111 Hallsworth, List, Metcalfe & Vlaev, *supra* note 105, at 3.
112 *Id.*
113 *See* Holz, List, Zentner, Cardoza & Zentner, *supra* note 62, at 2.
114 *Id.* at 9–10.
115 *Id.* at 3, 24.
116 *Id.* at 3, 14.
117 *See, e.g.*, INTERNAL REVENUE SERV., *supra* note 1.

return schedules) blank.[118] This design feature almost certainly leads to lower compliance by taxpayers, likely due to a combination of omission bias, status quo bias, and a perception by taxpayers that they will not be heavily penalized (or penalized at all) for such omissions.

The social science research discussed in this subpart demonstrates the importance that well-designed and penetrating questions can play in fostering tax compliance. A question that requires an affirmative answer does something that a blank (or an omitted) line on a tax return does not: It requires taxpayers to engage in acts of commission. Thus, strategic questions have the potential to capitalize upon the human condition by making it psychologically harder to lie and also by creating the perception of a greater risk of punishment for doing so—which is illustrated in the next subpart with an examination of two historical case studies that demonstrate the power of asking strategic questions.

B. *Historical Case Studies*

There is robust historical evidence that when questions are strategically asked, they can elicit critical information and improve tax compliance. To demonstrate this point, Section 1 below presents a case study involving requests for dependents' Social Security numbers, and Section 2 presents a second case study involving requests for the employer identification numbers of taxpayers' childcare providers. Section 3 discussions implications of the case studies.

1. *Case Study #1: Request for Dependents' Social Security Numbers*

Prior to 1986, the Code allowed taxpayers to secure a personal exemption (the equivalent of a deduction) on their income tax for any dependent residing in their household.[119] The legislative reason cited for this exemption was to protect from "income tax . . . [a] minimum standard of living."[120] However, when the IRS conducted audits, the agency frequently learned that those whom taxpayers designated as dependents were nonexistent, fictitious children.[121]

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[118] *See generally*, GAO TAX GAP REPORT, *supra* note 29.

[119] I.R.C. § 151(a)–(c). The personal exemption was part of the nation's modern income tax. *See* Revenue Act of 1913, Pub. L. No. 63-16, ch. 16, § II.C, 38 Stat. 114, 168 (granting every taxpayer a personal exemption of $3,000, plus an additional $1,000 if married). In 1916, the special allowance was extended to any "head of a family." Revenue Act of 1916, Pub. L. No. 64-271, ch. 463, § 7(a), 39 Stat. 756, 761. Finally, in 1917, Congress authorized a deduction for each dependent child under the age of 18 or incapable of self-support because of a mental or physical disability. War Revenue Act of 1917, Pub. L. No. 65–50, ch. 63, § 1203(1), 40 Stat. 300, 331.

[120] *See* HOWARD SELTZER, THE PERSONAL EXEMPTION IN THE INCOME TAX 155 (1968).

[121] *See The IRS' Case of Missing Children*, L.A. TIMES (Dec. 11, 1989), https://www.latimes.com/archives/la-xpm-1989-12-11-me-33-story.html

This certainly constituted fraudulent reporting on the taxpayers' part; however, on an individual basis, the tax dollar amounts were meager, and, hence, the IRS neither routinely nor vigorously pursued criminal enforcement.[122]

One IRS auditor, John Szilagyi, harbored particularly strong misgivings regarding the then state of affairs.[123] Extrapolating from his own experience in conducting taxpayer field audits, he thought that personal exemption abuse was extraordinarily pervasive and that, at an aggregate level, significant amounts of tax revenue were at stake.[124] Szilagyi therefore asked his superiors if the IRS would add a question to all income tax returns requesting each dependent's Social Security number.[125] Folklore indicates that his immediate superiors greeted this request with a healthy dose of skepticism.[126]

In 1986, the tax landscape dramatically shifted. At that time, President Ronald Reagan and a bipartisan group of House and Senate members decided to significantly lower income tax rates.[127] To make the proposed legislation revenue neutral, this necessitated broadening the tax base, along with "painless measures" to strengthen taxpayer compliance and raise additional tax revenue without raising tax rates.[128] This quest sparked renewed interest in Szilagyi's

[https://perma.cc/WDF8-6UXE] ("For a lot of years, millions of children were apparently and profitably created not in the usual way but solely through acts of imagination.").

[122] Another possibility is that once taxpayers were caught lying, there were no counterarguments that they could make; and hence they had to concede immediate defeat, resulting in no published court decisions. Indeed, the only published decisions are those involving the permissibility of the personal exemption. See, for example, Reese v. Comm'r, 36 T.C.M. (CCH) 1665 (1977) ("The disallowance on his 1971 income tax return of petitioner's claimed dependency exemptions under section 151(a) and section 152(a)(1) for his three children is upheld because of petitioner's failure to sustain his burden of proof that he provided over half of the support for these children.").

[123] *See* Stephen J. Dubner & Steven D. Levitt, *Filling the Tax Gap*, N.Y. TIMES (Apr. 2, 2006), https://www.nytimes.com/2006/04/02/magazine/filling-in-the-tax-gap.html [https://perma.cc/RX98-NTMZ].

[124] *See id.* ("In the early 1980's, an I.R.S. research officer in Washington named John Szilagyi had seen enough random audits to know that some taxpayers were incorrectly claiming dependents for the sake of an exemption.").

[125] *Id.* ("Szilagyi decided that the most efficient way to clean up this mess was to simply require taxpayers to list their children's Social Security numbers.").

[126] *Id.* ("'Initially, there was a lot of resistance to the idea,' says Szilagyi, now retired to Florida. 'The answer I got was that it was too much like "1984."' The idea never made its way out of the agency.").

[127] *See* Daniel L. Simmons, *The Tax Reform Act of 1986: An Overview*, 1987 BYU L. REV. 151, 151 (1987) ("The Tax Reform Act of 1986 (the 1986 Act) represents a significant change in the direction of United States tax policy. Tax policy makers purchased a major reform in terms of a broadened tax base, that is, an expanded definition of income subject to the income tax, at the cost of substantially reduced marginal rates of tax on upper income taxpayers and a lesser reduction of marginal rates on others.").

[128] *See* STAFF OF JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX REFORM ACT 1986, H.R. REP. NO. 99-3838, at 7–10 (1987) (among other things, discussing the Act's goal of achieving revenue neutrality).

idea of adding a question on individual income tax returns requesting the Social Security numbers of all taxpayers' dependents.[129]

The rest is history. As part of the Tax Reform Act of 1986, Congress added subsection (e) to Code section 151, requiring that taxpayers supply the Social Security number for any dependent age 5 or older.[130] To conform to this requirement, the IRS reformulated Form 1040 (U.S. Individual Income Tax Return) to request this information.[131] What happened next stunned politicians and the public alike.[132] With the enactment of this reform for the following year's tax filings, 7 million previously claimed dependents disappeared into thin air, resulting in an additional $3 billion of annual tax revenue.[133]

This information extraction exercise proved so successful that two further iterations of it followed. In 1988, as part of the Family Support Act of 1988, Congress lowered to age 2 the need to supply dependents' Social Security numbers;[134] and in 1996, as part of the Small Business Job Protection Act of 1996, the nation's legislative body expanded the mandate to Social Security numbers of all dependents, regardless of age.[135] The by-product of these reforms generated billions of dollars more in additional revenue without having to raise tax rates.[136]

2. *Case Study #2: Request for Employer Identification Numbers*

Well over a half century ago, in 1954, Congress created a deduction of up to $600 for expenses incurred for the care of children under the age of 12 and other dependents who were incapable of caring for themselves.[137] In 1976,

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[129] *Id.* at 1286–87.

[130] *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 1524(a), 100 Stat. 2085, 2749 (I.R.C. § 6109(e) before repeal in 1996).

[131] Page 1 of Form 1040 specifically asks for the name and Social Security number of each dependent of a taxpayer. INTERNAL REVENUE SERV., *supra* note 1, at 1.

[132] *See* Dubner & Levitt, *supra* note 123.

[133] *Id.* ("A few years later, however, with Congress clamoring for more tax revenue, Szilagyi's idea was dug up, rushed forward and put into law for tax year 1986. When the returns started coming in the following April, Szilagyi recalls, he and his bosses were shocked: seven million dependents had suddenly vanished from the tax rolls, some incalculable combination of real pets and phantom children. Szilagyi's clever twist generated nearly $3 billion in revenues in a single year.").

[134] *See* Family Support Act of 1988, Pub. L. No. 100-485, § 704, 102 Stat. 2343, 2427–28.

[135] *See* Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1615(a), 110 Stat. 1755, 1853–54 (repealing I.R.C. § 6109(e) and codified as amended in § 151(e)).

[136] *See* John A. Szilagyi, *Where Have All the Dependents Gone?*, *in* INTERNAL REVENUE SERVICE, 1990 UPDATE: TREND ANALYSES AND RELATED STATISTICS 63, 63 (1990).

[137] *See* I.R.C. § 214(b) (repealed 1976). The deduction was available only to working women and widowers. I.R.C. § 214(a). This deduction owes its origin to Smith v. Comm'r,

Congress transformed this deduction into a credit housed in the predecessor to Code section 21.[138]

Code section 21 allows a tax credit of 35 percent (reduced to as low as 20 percent depending on the taxpayer's adjusted gross income)[139] for so-called employment-related expenses[140] (often in the nature of childcare) expended on behalf of a qualifying individual, namely, a dependent under the age of 13 or a spouse who is physically or mentally incapable of caring for himself or herself.[141] Under current law, the credit amount is capped at $3,000 if there is one qualifying individual or $6,000 if there are two or more qualifying individuals.[142]

Congressional action to assist working individuals and couples to offset their childcare expenses was greeted with universal approbation.[143] However, over time, there developed a deep-seated dual fear that not all purported childcare providers were actually in existence and, in addition, that not all of them were accurately reporting the revenue they were receiving.[144] Taking a page from the success it had achieved in the personal exemption realm, Congress decided that reform was in order.[145] As part of the Family Support

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40 B.T.A. 1038, 1038 (1939), *aff'd per curiam*, 113 F.2d 114 (2d Cir. 1940). In *Smith*, married taxpayers both worked outside of their house and could not provide childcare. *Id.* at 1038. Accordingly, they hired a nursemaid and sought to deduct this outlay as being trade or business in nature. *Id.* The IRS disagreed, deeming such expenditures to be nondeductible personal consumption. *Id.* at 1039. The Board of Tax Appeals agreed with the Commissioner, but Congress decided that under these circumstances (i.e., parents whose work necessitates the need for childcare), tax relief was in order. *Id.* at 1039; *See* I.R.C. § 214(a). Pre-1976 law is discussed in Alan L. Feld, *Deductibility of Expenses for Child Care and Household Services: New Section 214*, 27 TAX L. REV. 415, 416–18 (1972), and Alan L. Feld, *Another Word on Child Care*, 28 TAX L. REV. 546, 546 (1973).

138 *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1520, 1563–65 (1976) (establishing dependent care credit, codified at I.R.C. § 44A (1976), and repealing I.R.C. § 214).

139 I.R.C. § 21(a)(2).

140 *Id.* § 21(b)(2).

141 *Id.* § 21(b)(1).

142 *Id.* § 21(c).

143 *See* S. REP. NO. 94-938, at 133 (1976) ("The committee views qualified childcare expenses as a cost of earning income and believes that an income ceiling on those entitled to the allowance has minimal revenue impact if the allowance is in the form of a credit. Therefore, it considers it appropriate and feasible to eliminate the income phaseout and to allow all taxpayers to claim such expenses regardless of their income level.").

144 *See* Tamar Lewin, *I.R.S. Sees Evidence of Wide Tax Cheating on Child Care*, N.Y. TIMES (Jan. 6, 1991), https://www.nytimes.com/1991/01/06/us/irs-sees-evidence-of-wide-tax-cheating-on-child-care.html?searchResultPosition=1 [https://perma.cc/42G8-TUSW] ("The Internal Revenue Service has striking new evidence that large numbers of Americans have been cheating on their taxes, claiming deductions for children who do not exist and child-care credits for baby sitters who are paid cash under the table.").

145 *Id.*

Act of 1988,[146] Congress instituted a new compliance requirement for the childcare credit.[147] Going forward, taxpayers seeking to secure the credit would have to identify their day-care providers via the latter's employer identification number.[148] This requirement was implemented by adding another question to Form 1040.[149]

In a tax-compliant world, adding this requirement should have been a nonevent. However, instituting this obligation once again had significant effects. The number of taxpayers reporting qualification for this tax credit dropped nearly 20 percent, from 8.7 million in 1988 to 6.1 million in 1989, and the corresponding "cost" to the federal government (i.e., taxpayers availing themselves of this tax credit) plunged in 1989 to $2.5 billion from $3.7 billion in 1988.[150] Simultaneously, the number of childcare providers skyrocketed nearly 65 percent from 262,000 in 1988 to 431,000 in 1989.[151] The institution of this employer identification requirement demonstrated the sheer number of both taxpayers and childcare providers who were being derelict in their tax-reporting practices.

3. *Implications of the Case Studies*

What these two case studies strongly suggest is that strategically asked questions can both improve the honesty of taxpayer reporting and provide a wealth of useful data that levels the information playing field between taxpayers and the IRS. The reason for enhanced tax compliance is likely that the new information supplied by taxpayers could be verified with other information that the IRS already possessed (for example, the Social Security numbers of dependents) or would receive (for example, from third-party tax information returns).[152]

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[146] *See* Family Support Act of 1988, Pub. L. No. 100-485, § 1(a), 102 Stat. 2343, 2343 (1988).

[147] *Id.* § 703(a)–(c)(1), 102 Stat. 2426-27.

[148] *See* I.R.C. § 21(e)(9). This information is solicited on Form 2441 ("Child and Dependent Care Expenses"), which, if a childcare tax credit is sought, must accompany Form 1040. *See* INTERNAL REVENUE SERV., FORM 2241 (2022), https://www.irs.gov/pub/irs-pdf/f2441.pdf [https://perma.cc/GT6L-LJYH].

[149] *See* INTERNAL REVENUE SERV., *supra* note 1.

[150] *See* Lewin, *supra* note 144; *Millions Cheat on Dependent Claim—IRS*, L.A. TIMES (Nov. 16, 1990), https://www.latimes.com/archives/la-xpm-1990-11-16-fi-4934-story.html [https://perma.cc/HL4L-ET8P].

[151] *See* Lewin, *supra* note 144.

[152] *See,* Robert J. Fedor, *What You Should Know About the IRS Automated Underreporter*, ROBERT J. FEDOR ESQ., LLC, (Jan. 17, 2023), https://www.fedortax.com/blog/what-you-should-know-about-the-irs-automated-underreporter [https://perma.cc/QRZ4-37SH] ("[T]he AUR is a partially automated process whereby your tax return is matched against information returns gathered by the IRS. Information returns and schedules available to the IRS are extensive, including much more than just W-2 and 1099 forms. Once the taxpayer is matched to their Social Security

Additionally, and importantly, it did not appear to matter that this information was not being automatically cross-checked in a method akin to the AUR program. Taxpayers were not told that their dependents' Social Security numbers would be automatically matched in an IRS database; and, at the time (a time of paper returns), this would have been difficult to do.[153] Even so, many taxpayers began to report more honestly.[154] The implications of this are significant: simply asking a tax return question that requires the taxpayer to supply verifiable information significantly increases compliance.

The two case studies further suggest that when Congress and the IRS know that a specific area of compliance is problematic, they should institute immediate reform measures that include the gathering of additional information. With the assistance of various social science studies, Part IV explores the manner in which this could be accomplished.

IV. PROBLEM AREAS AND PROPOSED REFORMS

By historical standards, tax return preparation has never been easier.[155] In yesteryear, taxpayers would have to manually gather and input information relating to the income that they earned, the deductions that they incurred, and the investment profits and losses that they experienced.[156] Numerical computations could be numbingly complex, particularly for those taxpayers who lacked the skills to handle anything mathematical in nature.[157] Over time, third-party tax information returns have gradually alleviated the need to collect and organize this data, and computer software programs have all but eliminated any mathematical computational concerns.[158] More recently, due to

number, the tax and information returns are compared to identify mistakes and potential omissions on the tax return.").

[153] *See* INTERNAL REVENUE SERV., INSTRUCTIONS FOR PREPARING FORM 1040, 2 (1987)., https://www.irs.gov/pub/irs-prior/i1040--1987.pdf [https://perma.cc/33RB-UKZ3].

[154] *See* Dubner & Levitt, *supra* note 123.

[155] *See, e.g.*, Jeffrey H. Kahn & Gregg D. Polsky, *The End of Cash, the Income Tax, and the Next 100 Years*, 41 FLA. STATE U. L. REV. 159, 159 (2013) ("Technological improvements have made third-party reporting and withholding more efficient, which has allowed these mechanisms to become more pervasively used. Tax compliance software has made it easier for professional tax preparers and taxpayers alike to prepare and file tax returns and information statements. Technology has also made it easier for taxpayers to substantiate their activities; the proverbial shoebox full of receipts is disappearing.").

[156] *See, e.g.,* I.R.S. Fact Sheet FS-2011-10 (June 2011), https://www.irs.gov/pub/irs-news/fs-11-10.pdf [https://perma.cc/2K8T-NS2U] (detailing the history of E-file).

[157] Admittedly, prior to the advent of computer software, Congress was sensitive to making mathematical computations too challenging. *See, e.g.*, Lawrence Zelenak, *Complex Tax Legislation in the TurboTax Era*, 1 COLUM. J. TAX L. 91, 91 (2010).

[158] *See, e.g.*, Kathleen DeLaney Thomas, *User-Friendly Taxpaying*, 92 IND. L.J. 1509, 1552 (2017) ("For taxpayers who self-prepare online, tax-preparation software undoubtedly simplifies the process and makes filing less burdensome. For example,

further technological advances, most numerical entries that appear on third-party tax information returns can be readily downloaded with a simple keystroke or two,[159] obviating the need for taxpayers to do so. Accordingly, tax return preparation that in the past may have taken hours on end to complete can now be accomplished in a fraction of the time.[160]

The technological obliteration of many of the nettlesome chores historically associated with tax return preparation affords a unique opportunity to the IRS. Without being overly burdensome with respect to a taxpayer's time, the agency may now ask piercing questions, with the goal of fostering greater voluntary tax compliance. Such questions are useful regardless of whether individuals utilize these new technologies, as demonstrated by the previously discussed examples. However, the growing use of automated tax return preparation makes the case for these questions even stronger. Admittedly, the IRS must act with circumspection and not be overly intrusive, peppering taxpayers with an onslaught of vacuous and meaningless questions.[161] Instead, the agency should ask only those questions that are carefully calibrated and designed to probe those areas where tax compliance has proven problematic.[162]

Below, Subpart A explores five areas that tax administrators have identified as posing significant tax compliance challenges.[163] Next, Subpart B

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taxpayers can save and review prior year returns, carry over relevant information to future years, and click through questionnaires to help them determine which tax rules apply to them. Software programs will also handle calculations and automatically apply rules like deduction phaseouts for the taxpayer.").

159 *See, e.g.*, Melanie Pinola, *The Best Online Tax Filing Software*, N.Y. TIMES (2022), https://www.nytimes.com/wirecutter/reviews/best-tax-software/ [https://perma.cc/XWC7-5EK9] ("Doing your taxes may never be fun, but the right tool can turn the worst annual chore into a manageable—and, dare we say, rewarding—afternoon. The best tax software ensures you get all the credits and deductions you deserve, without dragging you through forms hell."); Jay A. Soled, *Complexity, Computers, and the Code: Dawn of a New Era*, 73 TAX NOTES TODAY 471, 471-72 (Oct. 1996) (explaining how computer software has greatly facilitated tax return preparation).

160 *See* Soled, *supra* note 159, at 471.

161 *See Understanding Taxpayer Rights: The Right to Privacy,* INTERNAL REVENUE SERV. (Nov. 24, 2021) https://www.irs.gov/newsroom/understanding-taxpayer-rights-the-right-to-privacy [https://perma.cc/XP7R-SQCJ].

162 *See* Bankman, Nass & Slemrod, *supra* note 3, at 472 ("[T]he fact the government asks more specific questions sends signals about the government's knowledge and motivation.").

163 *See* CHARLES RETTIG, INTERNAL REVENUE SERV., A CLOSER LOOK: IMPACTING THE TAX GAP 3 (rev. June 2010), https://www.irs.gov/pub/foia/ig/cl/tax-gap-for-web.pdf [https://perma.cc/X3EY-GC4X] (describing virtual currencies, "unreported offshore income," "concealment through the use of pass-through entities," and "illegal source income" as the biggest compliance challenges not currently captured by tax gap estimates). On the other hand, tax gap estimates do identify cash economy income—that is, income not subject to third-party information reporting or withholding—as a "major contributor" to the tax gap. *Id.* at 4.

explores a case study concerning a reporting question aimed at foreign accounts and discusses lessons learned. Subpart C then suggests provocative questions that the IRS should raise that, based on social science research, should nudge taxpayers toward greater compliance.[164] Finally, Subpart D addresses possible logistical concerns associated with asking these questions.

A. *Tax Compliance Problem Areas*

The five areas of tax noncompliance that this Article details are as follows: (1) unreported cash and cash equivalents, (2) virtual currencies, (3) household employees, (4) foreign bank accounts, and (5) tax shelter investments.

1. *Unreported Cash and Cash Equivalents*

Since Congress introduced the income tax in 1913,[165] the problem of unreported cash and cash-equivalent income (for example, checks made payable to cash) has plagued tax compliance.[166] The reason is simple: there is no documentation or electronic tracing that enables the IRS to easily detect its receipt, and taxpayers know and exploit this.

A straightforward example aptly portrays these dynamics. Suppose a handyman offers to paint a taxpayer's home for $15,000. If, however, the taxpayer is willing to pay in cash, the handyman offers to lower the price to $10,000. Assuming the handyman's marginal tax bracket is 40 percent, from his perspective this arrangement makes a great deal of financial sense. Instead of commanding a net after-tax profit of $9,000 (i.e., $15,000 – (.4 x $15,000)), he can net $10,000 (assuming he does not report the cash receipt). From the taxpayer's perspective, too, this arrangement makes a lot of financial sense because she can pay only $10,000 for services worth $15,000. Indeed, the only "loser" in this whole arrangement is the federal government, which fails to collect any tax revenue.[167]

Both Congress and the IRS have sought to police these sorts of taxpayer shenanigans. Code section 6050I, for example, requires that financial institutions and other vendors that receive cash payments that equal $10,000 or more report such receipts to the IRS.[168] In a number of instances, this

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[164] *See, e.g.*, Thomas, *supra* note 62, at 621 (arguing that nudges are a cost-effective way to improve tax compliance).

[165] *See* Tariff Act of 1913, Pub. L. No. 63-16, 38 Stat. 114, 166 (1913) (current version at I.R.C. § 1(a)–(e) (2012)).

[166] *See, e.g.*, Morse, Karlinsky & Bankman, *supra* note 15, at 37 ("According to government reports, most individuals with business income fail to pay all their taxes, although some appear to cheat more than others. Underpayment of tax on business income is commonly attributed to the receipt of cash.").

[167] *See* Jay A. Soled, *Honest Taxpayers and the Tax Gap: It Takes Two to Tango*, 76 TAX NOTES 983, 983 (1997) (explaining how so-called honest taxpayers abet tax cheating).

[168] *See* I.R.C. § 6050I(a).

reporting requirement has proven instrumental in forcing taxpayers to divulge their cash payments.[169] In other cases, the reporting requirement has led to the detection of unreported income.[170] Further, Congress recently expanded third-party tax information rules to require payment processors like Venmo and PayPal to report business payments that exceed $600, thus ensuring that more independent contractors like Uber drivers will report their income.[171] Nevertheless, as the IRS compliance statistics demonstrate,[172] as long as a taxpayer's income is not reported on Form 1099, compliance rates remain around 50 percent.[173]

The IRS, too, has sought to be vigilant in detecting the receipt of unreported taxpayer income. One common audit methodology in the IRS tool chest is the use of the so-called bank deposits method.[174] As a central element of this method, the IRS compares what the taxpayer reports to be his income on his tax return to what the taxpayer deposits in the bank.[175] If a significant discrepancy between the two amounts appears, then the agency recognizes that an audit may be appropriate.[176] If the taxpayer cannot explain the discrepancy (for example, the taxpayer did not receive any large cash gifts or bequests), then there is a clear indication that the taxpayer was derelict in his reporting practices.[177]

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169 *See* I.R.S. *supra note* 26.

170 *See, e.g.*, United States v. McLamb, 985 F.2d 1284, 1284–85 (4th Cir. 1993) (car dealership owner convicted for structuring a vehicle sale designed to avoid cash reporting requirement); Lefcourt v. United States, 125 F.3d 79, 79 (2d Cir. 1997) (penalty imposed on taxpayer who willfully omitted client-identifying information); United States v. Loe, 262 F.3d 427, 429 (5th Cir. 2001) (taxpayer who was paid $21,000 cash for a boat and failed to file an information return did so intentionally and, accordingly, was subject to criminal prosecution).

171 *See* I.R.C. § 6041(a) (lowering information reporting threshold from $20,000 to $600).

172 *See* I.R.S. *supra* note 23, at 30.

173 *Id.*

174 *See* MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE AND PROCEDURE 7B-12 to -13 (2d ed., 1991) ("Under the bank deposits method (1) the taxpayer's bank deposits and cash expenditures are totaled; (2) nonincome deposits, redeposits, or transfers are eliminated; and (3) an excess of deposits as adjusted over reported income is assumed to constitute unreported income. The bank deposits method has been sanctioned in civil tax penalty cases, including those involving the fraud penalty. This method serves to establish additional income and fraud, an issue on which the Commissioner has the burden of proof. Bank deposits standing alone do not prove the receipt of income. Nevertheless, some courts say that bank deposits, where established to be in excess of reported income, are prima facie evidence of income, which shifts the burden of coming forward with evidence that the payments are not income to the taxpayer.").

175 *Id.*

176 *See id.*

177 *See, e.g.*, Rodney v. Comm'r, 53 T.C. 287, 315 (1970) ("However, where from surrounding circumstances it is a fair inference that the deposit is made up of income, it is proper for the Commissioner to make a determination on that ground."); Goe v. Comm'r,

Notwithstanding congressional and IRS oversight, the receipt of cash and cash equivalents remains wholly problematic.[178] Again, this includes not only income earned in physical cash (perhaps increasingly less common as the economy gravitates more toward online transactions) but also any income that escapes third-party tax information reporting.[179] As IRS compliance data demonstrate, this frequently includes cash or cash-equivalent business income, such as that earned by sole proprietors or farmers, as well as certain rental income and royalty income.[180]

2. *Virtual Currencies*

In recent years, both the IRS Commissioner and the Treasury Inspector General for Tax Administration have highlighted virtual currencies (such as Bitcoin) as a growing area of concern for tax administration.[181] As IRS

198 F.2d 851, 852 (3d Cir. 1952) ("Here we find in the record reasonable basis for the inference drawn by the Commissioner and the Tax Court and for their conclusion that the money banked by the taxpayer represented unreported income."); Halle v. Comm'r, 175 F.2d 500, 503 (2d Cir. 1949) ("Again, for 1936, taxpayer reported a loss of $2,451.44, yet there was evidence to show that during this year taxpayer deposited in two banks, to the account of his wife and himself, sums in excess of $80,000. Nor could taxpayer explain this (at least) apparent discrepancy. Often, when called on to explain important items involving substantial sums of money, taxpayer resorted merely to a general statement that his returns were true and correct."); Clayton v. Comm'r, 102 T.C. 632, 646 (1994) ("The agent then totaled the bank deposits net of transfers for each year and subtracted the income as reported on petitioners'1989 tax return, and the delinquent 1990 return. These computations produced unexplained deposits of $54,994 for 1989, and $16,909 for 1990. Under respondent's application of the bank deposit method these amounts are assumed to be unreported taxable income, and we so hold.").

[178] *See, e.g.*, Morse, Karlinsky & Bankman, *supra* note 15, at 37.

[179] *Id.*

[180] *See* RETTIG, *supra* note 163, at 4 ("In terms of what makes up the Tax Gap, the underreporting of business income by individual taxpayers—income of sole proprietors, farmers and those earning rental, royalty, partnership, and S Corporation income—is a major contributor . . . . The lack of reliable and comprehensive reporting and withholding for business income received by individuals is a significant reason for these findings."). *See also* Natasha Sarin, *The Case for a Robust Attack on the Tax Gap*, U.S. DEP'T TREASURY (Sept. 7, 2021), https://home.treasury.gov/news/featured-stories/the-case-for-a-robust-attack-on-the-tax-gap [https://perma.cc/7LHU-3RTD].

[181] *See* RETTIG, *supra* note 163, at 3 ("[T]he estimated Tax Gap for TY2011–2013 might be understated to the extent that they don't fully reflect the noncompliance associated with a measure attributable to compliance by taxpayers conducting transactions in virtual currencies."); *Understanding the Tax Gap and Taxpayer Noncompliance: Hearing Before the H. Comm. on Ways & Means*, 116th Cong. 9 (2019) (testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration) [hereinafter TIGTA Hearing], https://www.tigta.gov/sites/default/files/publications/2021-11/congress_05092019.pdf [https://perma.cc/H8GH-QKAH] ("Virtual currencies continue to present a significant risk to tax administration, particularly since one of the attractions to their use is the anonymity of transactions.").

Commissioner Charles Rettig highlighted in recent remarks on the tax gap, "[t]here are now approximately 8,600 virtual currencies with a current global market cap of almost $2 trillion."[182] Although the IRS has issued guidance on virtual currencies to clarify that they should be treated like property and subject to tax upon exchange,[183] many taxpayers who would otherwise intend to be honest may simply fail to appreciate the tax consequences of virtual currency transactions.[184]

Further, the anonymous nature of virtual currency ownership presents a major obstacle to IRS enforcement.[185] Certain third-party tax information rules apply to virtual currency.[186] For example, if an independent contractor is paid in virtual currency, the same Form 1099 reporting rules are supposed to apply as would be the case if a third-party site like Venmo or PayPal were used.[187] Nevertheless, because ownership of virtual currency is anonymous and so resembles cash, the IRS does not have the ability to track such transactions to the same degree that it would a bank account held in a taxpayer's name.[188] Further, when it comes to virtual currency transactions, it is unclear if third-party reporters are adhering to information reporting requirements, and the IRS cannot easily identify whether proper Form 1099 protocol is being followed.[189] For these reasons, the Treasury Inspector General for Tax Administration has recommended that Form 1099 rules be accordingly updated, thus increasing transparency for the IRS.[190] To date, the IRS has made some attempts to increase enforcement activity with respect to virtual currency, but there has not yet been data reflecting whether compliance has

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182 RETTIG, *supra* note 163, at 3.

183 I.R.S. Notice 2014-21, 2014-16 I.R.B. 938.

184 *See* Nicholas Vega, *The IRS May be Missing Out on $50 billion a Year in Unpaid Crypto Taxes—and a Crackdown Is Underway*, CNBC (May 18, 2022), https://www.cnbc.com/2022/05/18/irs-may-be-missing-out-on-50-billion-dollars-a-year-in-unpaid-crypto-taxes.html [https://perma.cc/JH2H-UE7U] (discussing taxpayers' reluctance to report virtual currency transactions).

185 *See* TIGTA Hearing, *supra* note 181, at 9.

186 *See id.*

187 *See id*. Additionally, starting in 2023, virtual currency exchanges are required to report transactions on Form 1099-B. *See infra* note 255 and accompanying text.

188 *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., AS THE USE OF VIRTUAL CURRENCIES IN TAXABLE TRANSACTIONS BECOMES MORE COMMON, ADDITIONAL ACTIONS ARE NEEDED TO ENSURE TAXPAYER COMPLIANCE 12–13 (Sept. 2016), https://www.treasury.gov/tigta/auditreports/2016reports/201630083fr.pdf [https://perma.cc/HQW7-MF67].

189 *See* Greg Iacurci, *Cryptocurrency Poses a Significant Risk of Tax Evasion*, CNBC (May 31, 2021), https://www.cnbc.com/2021/05/31/cryptocurrency-poses-a-significant-risk-of-tax-evasion.html [https://perma.cc/MJK6-RJKK] ("The IRS may not be able to trace crypto income or transactions if they go unreported by exchanges, businesses and other third parties. And that means the income may not be taxed.").

190 *See* TIGTA Hearing, *supra* note 181, at 9.

improved.[191] Importantly, this is an area where tax administrators have already turned to using a tax return question to bolster compliance.[192]

3. *Household Employees*

Many taxpayers retain the services of household employees such as cooks, drivers, health aides, house cleaners, nannies, private nurses, and yard workers.[193] When such arrangements constitute an employment relationship, the Code imposes designated employment tax responsibilities upon taxpayers.[194] The scope of employment taxes includes the Federal Social Security and Medicare taxes administered under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA).[195] If certain wage thresholds are met, employment tax reporting is mandatory, and payments are due and owing. [196] In the case of FICA taxes, the total tax rate is 15.3 percent of the remuneration paid (which is borne equally by employers and employees);[197] and, in the case of FUTA taxes, the tax rate is equal to 6 percent of the remuneration paid with its payment entirely on the employer's shoulders.[198]

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[191] *See id.* ("[T]he IRS has taken steps towards ramping up compliance efforts, including seeking information with respect to virtual currency account holders with significant virtual currency assets. However, the IRS has not taken action on TIGTA's recommendation to update relevant information returns to allow for the designation of virtual currency transactions.").

[192] *See infra* Part IV.C.

[193] *See, e.g.*, Catherine B. Haskins, Household Employer Payroll Tax Evasion: An Exploration Based on IRS Data and on Interviews with Employers and Domestic Workers (Feb. 2010) (Ph.D. dissertation, University of Massachusetts Amherst), https://scholarworks.umass.edu/open_access_dissertations/163/ (on file with the *Ohio State Law Journal*).

[194] These employment tax responsibilities are spelled out in detail in *Publication 15*. INTERNAL REVENUE SERV., PUBLICATION 15, (CIRCULAR E), EMPLOYER'S TAX GUIDE 11 (Dec. 2022), https://www.irs.gov/pub/irs-dft/p15--dft.pdf [https://perma.cc/358W-CDU2].

[195] *See* I.R.C. ch. 21 §§ 3101(a), 3111(a) (Federal Insurance Contributions Act); I.R.C ch. 23 § 3304(a) (Federal Unemployment Tax Act).

[196] In the case of FICA taxes, in 2023 the threshold amount is $2,600 or more paid annually *See* I.R.C. § 3121(x) (adjusting the wage base annually for inflation); EMPLOYMENT COVERAGE THRESHOLDS, SOC. SEC. ADMIN., https://www.ssa.gov/OACT/COLA/CovThresh.html [https://perma.cc/WH5G-VBLM] (social security wage thresholds). In the case of FUTA, the threshold amount is $1,000 or more paid quarterly. I.R.C. § 3306(a)(3). This dollar amount is not adjusted annually for inflation.

[197] *See* I.R.C. § 3101(a)–(b) (imposing a 6.2 percent tax on employee wages for old-age, survivors, and disability insurance (OSDI) and an additional tax of 1.45 percent on wages for hospital insurance). Regarding OSDI, the Code imposes an identical obligation upon employers. I.R.C. § 3111(a)–(b).

[198] *See* I.R.C. § 3301.

Despite these rules and requirements, tax compliance for household employers has proven abysmal.[199] Indeed, one recent study indicates that the noncompliance rate hovers at an astounding rate of 95 percent.[200] The by-product of such noncompliance is that it generates an annual revenue gap estimated to be anywhere between $2.4 and $4 billion.[201] What is truly remarkable about this rampant noncompliance is that although it has been recognized for several decades,[202] neither the IRS nor Congress has taken any notable measures to curb it, and apparently there is little risk of employer taxpayer noncompliance being detected.

4. *Foreign Bank Accounts*

Commentators and tax administrators agree that failure to report offshore income continues to be a vexing compliance challenge.[203] For most of the history of the modern income tax, income generated in offshore accounts presented a compliance challenge: without third-party tax information reporting, it was virtually impossible for the IRS to know if such income actually existed.[204] Unsurprisingly, tax compliance regarding overseas accounts was historically abysmal.[205] In many instances, the income that taxpayers earned overseas could be hidden in so-called numbered accounts; and, due to many countries' bank secrecy laws, there was little chance that the IRS could detect taxpayers' derelictions.[206]

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[199] *See* KIM M. BLOOMQUIST & ZHIYONG AN, INTERNAL REVENUE SERV., GEOGRAPHIC VARIATION IN SCHEDULE H FILING RATES: WHY SHOULD LOCATION INFLUENCE THE DECISION TO REPORT "NANNY" TAXES? 57, 67 (2006) (offering empirical evidence of taxpayer noncompliance); Haskins, *supra* note 193, at 119.

[200] BRIAN ERARD, INTERNAL REVENUE SERV., WHO IS MINDING THE NANNY TAX? 197 (2018), https://www.irs.gov/pub/irs-soi/18resconerard.pdf [https://perma.cc/6EBD-AVY2].

[201] *Id.* at 198.

[202] *See, e.g.*, David Cay Johnston, *Despite an Easing of Rules, Millions Evade 'Nanny Tax,'* N.Y. TIMES (Apr. 5, 1998), https://www.nytimes.com/1998/04/05/business/despite-an-easing-of-rules-millions-evade-nanny-tax.html (on file with the *Ohio State Law Journal*) (this article was published a quarter century ago and, to date, no legislative proposals have been submitted to address this issue).

[203] *See* RETTIG, *supra* note 163, at 7.

[204] *See* Cynthia Blum, *Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?*, 6 FLA. TAX REV. 579, 595 (2004) ("IRS information-reporting generally does not extend to foreign payors or brokers.").

[205] *See generally Tax Haven Abuses: The Enablers, the Tools and Secrecy, Hearing Before the Permanent Subcomm. on Investigations, Comm. on Homeland Sec. & Gov't Affs.*, 109th Cong. (2006) [hereinafter *Tax Haven Abuses*] (statement of Sen. Norm Coleman, Chairman, Permanent Subcomm. On Investigations) ("The offshore problem has become one of staggering proportions. Offshore tax havens and financial secrecy jurisdictions hold an estimated $1.5 trillion in U.S. assets, resulting in a projected annual drain on the U.S. Treasury of $50 to $70 billion in lost taxes.").

[206] *See* Blum, *supra* note 204, at 595 ("Moreover, some foreign countries, such as Liechtenstein, Switzerland, and the Cayman Islands, have held themselves out as places

However, in the past 15 years, both legislative and administrative initiatives have significantly reduced the opaqueness that once surrounded offshore accounts, which has reduced evasion.[207] First, starting in 2008, the government paired increased criminal enforcement with a voluntary disclosure program that allowed taxpayers to voluntarily disclose unreported offshore income in order to avoid prosecution.[208] These efforts are estimated to have yielded $17 billion in revenue from 2009 to 2018.[209] Second, in 2010, Congress passed the Foreign Account Tax Compliance Act (FATCA), which, among other things, requires foreign financial institutions to report to the United States relevant information about their U.S. account holders.[210] Under FATCA, more foreign accounts are now subject to third-party tax information reporting by financial institutions, no doubt improving compliance when it comes to taxpayers reporting their income from those accounts.[211]

Notwithstanding these major changes to foreign account reporting, the Treasury, the IRS, and tax scholars have continued to cite foreign accounts as a major source of noncompliance, particularly by high-income taxpayers.[212] While it is significantly harder for taxpayers to conceal offshore income as compared to years past, some taxpayers may still view foreign tax havens as the easiest way to conceal significant income from the IRS.[213] Further, a 2018

where investors and depositors can be sure that their identity and holdings are secret, places where confidentiality is assured. In some cases, the government simply will not seek to collect information from banks; in other cases, the government may itself impose penalties on bank employees who breach secrecy. In any case, requests to the executive or judiciary of such a country for information related to taxes or to creditors' claims to collect debts will not be entertained. Apart from Switzerland, these are countries that do not have income tax treaties with the United States.").

207 *See* Robert T. Kudrle, *The New Global Attack on Personal Tax Evasion Using Foreign Investment and the Role of the United States*, 47 DENV. J. INT'L L. & POL'Y 147, 152 (2019) ("FATCA [Foreign Account Tax Compliance Act] was "a piece of extraterritoriality stunning even by Washington's standards." U.S. power to act unilaterally with success rested on the need of virtually all foreign investment institutions for access to U.S. financial markets and the threat that, if they failed to cooperate with the IRS by providing information on their accounts held by U.S. parties, all of the institution's U.S. investment would face a thirty percent withholding tax.").

208 DANIEL HEMEL, JANET HOLTZBLATT & STEVE ROSENTHAL, TAX. POL'Y CTR., THE TAX GAP'S MANY SHADES OF GRAY 15 (Feb. 2022), https://www.taxpolicycenter.org/sites/default/files/publication/163545/report-the-tax-gaps-many-shades-of-gray_1.pdf [https://perma.cc/YUM4-WHJ9].

209 *Id.* (citing $6 billion from enforcement activities and $11 billion of back taxes, interest, and penalties from voluntary disclosure).

210 *See* Foreign Account Tax Compliance Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

211 *See* HEMEL, HOLTZBLATT & ROSENTHAL, *supra* note 208, at 15.

212 RETTIG, *supra* note 163, at 3.

213 *See, e.g.*, S. FIN. COMM., 117th Cong., THE SHELL BANK LOOPHOLE 12–13, 18 (2022), https://www.finance.senate.gov/imo/media/doc/Mirabaud%20Report.pdf

report by the Treasury Inspector General for Tax Administration highlights problems that the government has faced in administering FATCA, such as the fact that many reports from foreign financial institutions appear to have missing or incorrect taxpayer identification numbers.[214]

However, it should also be noted that revenue loss estimates related to foreign account noncompliance generally rely on data that predates the implementation of FATCA, which has undoubtedly reduced evasion.[215] Thus, researchers need to conduct more studies to understand the scope of noncompliance with respect to offshore income in the present day, taking the new information reporting requirements into account.

5. *Tax Shelters*

For at least the past half century, tax shelters have been a ubiquitous feature of the nation's tax system.[216] Over this time period, tax shelter promoters have packaged them in a variety of forms. For example, in the 1960s, 1970s, and 1980s, taxpayers would purchase items (e.g., movie rights and title to real property) at greatly inflated prices from tax shelter promoters, simultaneously utilizing borrowed funds from these same promoters on a nonrecourse basis.[217] Thereafter taxpayers would take significant tax-saving depreciation and amortization deductions.[218] When Congress subsequently

[https://perma.cc/Y3TQ-HULL] (describing how wealthy taxpayers use shell companies to circumvent FATCA).

[214] *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., DESPITE SPENDING NEARLY $380 MILLION, THE INTERNAL REVENUE SERVICE IS STILL NOT PREPARED TO ENFORCE COMPLIANCE WITH THE FOREIGN ACCOUNT TAX COMPLIANCE ACT 14 (July 2018), https://www.tigta.gov/sites/default/files/reports/2022-02/201830040fr.pdf [https://perma.cc/7M4J-LC35].

[215] *See* HEMEL, HOLTZBLATT & ROSENTHAL, *supra* note 208, at 14 ("Setting aside any concerns about the $15 billion figure as an estimate for 2007, there are strong reasons to believe that offshore underreporting by U.S. households has fallen since 2007—not risen in step with income. Indeed, three of the authors of the Guyton et al. paper emphasize in a subsequent comment that their estimates 'reflect a time before the [U.S. offshore tax] enforcement that began in 2008,' and they specifically caution *against* '[m]apping the offshore estimates to today's policy environment' without more data." (emphasis added)).

[216] *See, e.g.*, David M. Schizer, *Enlisting the Tax Bar*, 59 TAX L. REV. 331, 331 (2006) ("Tax shelters have proliferated in the United States . . . ."). For excellent articles detailing tax shelter use, see generally David A. Weisbach, *Ten Truths About Tax Shelters*, 55 TAX L. REV. 215 (2002), and Jonathan H. Choi, *Beyond Purposivism in Tax Law,* 107 IOWA L. REV. 1439 (2022).

[217] See for example, Brannen v. Comm'r, 78 T.C. 471, 474–78 (1982), *aff'd*, 722 F.2d 695, 698 (11th Cir. 1984), where a taxpayer, seeking to shelter income from taxation, purchased from a tax shelter promoter at an inflated price a partnership interest that held rights to a movie and would generate future depreciation deductions.

[218] *See, e.g.*, Daniel N. Shaviro, *Risk and Accrual: The Tax Treatment of Nonrecourse Debt*, 44 TAX L. REV. 401, 431 (1989) ("In large part, tax-minded use of nonrecourse debt is simply a fortuitous byproduct of the relative risk aversion of many investors, especially

eradicated this generation of tax shelters,[219] taxpayers sought tax refuge elsewhere.[220] Many invested in various esoteric financial instruments that theoretically offered a scintilla of possible profitability but that were truly calibrated to generate huge losses equal to whatever dollar amount of gains the taxpayer sought to shelter.[221] For years, these esoteric financial instruments—tax shelters—flourished because they offered the attraction of artificial losses safeguarded from the economic risk of true losses.[222]

Despite the changing nature of tax shelters, they retain one item of consistency: they drain anticipated tax revenue from the federal coffers.[223] In recognition of the billions of dollars of tax revenue at risk, Congress has taken numerous legislative measures to curb tax shelters.[224] These efforts began in the 1980s when Congress first introduced the at-risk rules and then added the passive activity loss limitations.[225] More recently, to bolster the IRS litigation

those who are middle class rather than wealthy. Tax shelter promoters often need to attract such investors, not only as sources of capital, but also because such investors may be the only ones who can use tax benefits such as accelerated depreciation and tax credits.").

219 *See, e.g.*, Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REGUL. 77, 83 (2006) ("Congress effectively eradicated the first wave of tax shelters, which had been promoted primarily by financial advisers to middle income individuals, when it enacted rules that prohibit the use of passive losses to offset regular income in 1986."); George K. Yin, *Getting Serious About Corporate Tax Shelters: Taking a Lesson from History*, 54 SMU L. REV. 209, 218 (2001).

220 Rostain*, supra* note 219, at 83.

221 For a comprehensive overview of such tax shelters, see generally Karen C. Burke & Grayson M.P. McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 TAX LAW. 59 (2008). *See also* I.R.S. Notice 2002-50, 2002-28 I.R.B. 1 (describing a tax shelter transaction involving partnership straddles used to manufacture deductions); I.R.S. Notice 2002-35, 2002-21 I.R.B. 992 (describing contingent payment swap tax shelter utilizing notional principal contracts to generate current deductions without accruing income); I.R.S. Notice 2001-45, 2001-33 I.R.B. 129 (describing a tax shelter transaction utilizing Code section 318 attribution rules to shift stock basis and generate a realized loss).

222 Burke & McCouch, *supra* note 221, at 64 ("These [tax shelter] transactions typically involved a transfer to a partnership of property encumbered by contingent liabilities, resulting in high-basis, low-value partnership interests. By ignoring the effect of the contingent liabilities on outside basis, the shelter promoters purported to create a large artificial capital loss that could be used to offset unrelated capital gains.").

223 *See, e.g.*, Shannon Weeks McCormack, *Tax Shelters and Statutory Interpretation: A Much Needed Purposive Approach*, 2009 U. ILL. L. REV. 697, 699 (2009) ("In general, tax shelters refer to transactions carefully designed to fit within the letter of various provisions of the Code and Regulations to derive benefits unintended by those sections."); Joshua D. Blank, *Overcoming Overdisclosure: Toward Tax Shelter Detection*, 56 UCLA L. REV. 1629, 1635 (2009) ("An abusive tax shelter is a tax strategy that produces amazing tax benefits that Congress never envisioned, but that seem to flow, at least on a strict constructionist reading, from the text of the Internal Revenue Code.").

224 Rostain, supra note 219, at 96–97.

225 *See, e.g.*, Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. KAN. L. REV. 1065, 1137 n.310 (2003) ("Individual tax shelters of the 1970s and 1980s variety

position in tax shelter controversy cases, Congress enacted a general anti-abuse rule, which requires that for a transaction to be respected it must have economic substance.[226] Furthermore, the Treasury Department added a series of tax shelter disclosure provisions.[227] Along with Congress, the IRS has employed various measures to detect and to eradicate taxpayer tax shelter utilization. Such efforts include dedicating more resources to identifying tax shelter use and employing artificial intelligence to scour returns to determine if taxpayers are in tax compliance.[228]

However, despite these efforts, the IRS often falls short of achieving its goal of curbing tax shelter abuses.[229] Indeed, the most recent studies of tax noncompliance show that the wealthiest taxpayers are often able to hide their income through the use of complex, multitiered pass-through entities.[230] That being the case, strategically asked and well-placed questions in taxpayers' tax returns could prove advantageous in assisting the IRS in identifying those tax returns that require heightened scrutiny.

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were largely shut down by legislative changes to the Code, specifically the passive activity loss rules in section 469 and the at-risk rules in section 465.").

[226] I.R.C. § 7701(o); Karen C. Burke, *Reframing Economic Substance*, 31 VA. TAX REV. 271, 271–73 (2011) ("[I]t seems likely that § 7701(o) would strengthen the government's litigating position . . . .").

[227] *See* Treas. Reg. § 56.6011–4 (as amended in 2007) (taxpayer disclosure requirements); *see also* Treas. Reg. § 301.6111–3(d)(1) (as amended in 2011) (material adviser disclosure requirements).

[228] *See, e.g.*, Carina Federico & Travis Thompson, *Do IRS Computers Dream About Tax Cheats? Artificial Intelligence and Big Data in Tax Enforcement and Compliance*, 21 J. TAX PRAC. & PROC. 35, 36–37 (2019) (explaining IRS use of artificial intelligence to detect taxpayer noncompliance).

[229] *See e.g.* Blank, *supra* note 223, at 1631 ("Because tax shelters at first may appear to comply with the literal text of the Internal Revenue Code and resemble real business deals, they often fail to raise red flags for the IRS on their own.").

[230] The partnership structure creates a tax enforcement challenge because tax evasion can occur in two places: first, the partnership (or other pass-through entity) may fail to accurately report income to its partners (owners); and/or second, the owners may fail to accurately report the income on their individual tax returns. HEMEL, HOLTZBLATT & ROSENTHAL, *supra* note 208, at 12–13. Further complicating matters is that many pass-through arrangements, concentrated mostly among the wealthiest taxpayers, involve multitiered structures, where a partnership may be owned by another partnership that is owned by another partnership, and so on, making it difficult for the IRS to even find the individual owners. John Guyton, Patrick Langetieg, Daniel Reck, Max Risch, & Gabriel Zucman, *Tax Evasion at the Top of the Income Distribution: Theory and Evidence* 12 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28542, 2021) ("[I]f a wealthy taxpayer owns a network of private business interests, the auditor faces a considerable challenge in trying to assess the compliance of every single entity in the network.").

B. *A Question Case Study and Lessons Learned*

The preceding subpart described the most significant tax compliance challenges facing the IRS today. Understanding these areas should inform the types of tax return questions that would yield the biggest impact. The next subpart explores what those questions might look like. First, though, this subpart offers one more case study, this one in the context of foreign accounts, to offer a lesson for designing questions going forward.

This case study involves a question that has appeared, in one form or another, for decades on Schedule B ("Interest and Ordinary Dividends") of every Form 1040.[231] The question reads as follows: "At any time during 202[X], did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?"[232] For most of this question's existence, the IRS has lacked the ability to verify the accuracy of a taxpayer's response.[233] If the taxpayer responded "no," the IRS had no independent overseas third party that could verify or contradict what the taxpayer reported, and the IRS had no jurisdictional authority to access foreign banks or investment firms.[234] Thus, in responding to this question, many taxpayers apparently outright lied, and compliance in this area was appalling.[235]

Why was the tax return question asking for dependent Social Security numbers so wildly successful, while the question about foreign bank accounts was not? There is a crucial and obvious distinction between these questions: the Social Security number information was easily verifiable, while the foreign bank account information was not. Taxpayers undoubtedly knew the IRS lacked the ability to identify hidden overseas accounts, and research shows that this distinction matters: taxpayers who suspect that the IRS can easily verify the veracity of their answers fear getting caught more than taxpayers who doubt the IRS's ability to authenticate their responses.[236] This proposition is borne out by compliance data showing that voluntary compliance is significantly higher when the IRS possesses third-party tax information to verify taxpayer reporting.[237]

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[231] This requirement was added over a half century ago, in 1970, as part of the Bank Records and Foreign Transaction Act. Pub. L. No. 91-508, tit. II, ch. 4, § 241, 84 Stat. 1114, 1124 (1970). For legislative history, see generally H.R. REP. NO. 91-975.

[232] INTERNAL REVENUE SERV., SCHEDULE B: INTEREST AND ORDINARY DIVIDENDS (2022), https://www.irs.gov/pub/irs-pdf/f1040sb.pdf [https://perma.cc/CN75-UHXH].

[233] *See* Blum, *supra* note 204, at 595.

[234] *See id.* ("IRS information-reporting generally does not extend to foreign payors or brokers.").

[235] *See generally Tax Haven Abuses*, *supra* note 205.

[236] *See* Blum*, supra* note 204, at 595. *See also* Thomas, *supra* note 62, at 617 (describing how taxpayers feel discomfort being dishonest and the government can use this to increase tax compliance).

[237] *See supra* Part II.A.

When it comes to asking taxpayers questions, the distinction between verifiable and non-verifiable information is essential. Recall, for example, that the recent tax compliance study in the Dominican Republic revealed that evoking acts of commission coupled with the threat of sanctions was highly successful in improving tax compliance, while evoking acts of commission without the threat of sanctions was not.[238] Thus, comparing the question about offshore accounts with the question about the number of Social Security dependents offers both a compelling illustration of the social science research discussed above and an important lesson for designing tax return questions. Such questions can prove to be a powerful source of information that drives higher tax compliance, but the question will be most effective if the information requested and supplied is verifiable.

This provides reason to think that the tax return question about foreign accounts is now much more effective than when it was initially included on Schedule B of Form 1040. Recall that recent legislative and administrative changes have greatly increased the information available to the IRS when it comes to foreign accounts because under FATCA foreign financial institutions are required in many cases to report the identity of their account holders to the U.S. tax authorities.[239] Increasing transparency in turn significantly increases the risk of detection and the release of incriminating information to the IRS.[240]

These improvements in overseas account transparency are too recent for the IRS to have a good gauge of their overall impact on tax compliance. There is now some emerging—yet, inconclusive—research on the effects of FATCA.[241] However, given the proven track record of third-party tax information leading to higher tax compliance, there is every reason to believe that compliance in this area will improve.[242] Perhaps the best evidence for this

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[238] *See* Holz, List, Zentner, Cardoza & Zentner, *supra* note 62, at 3, 14–15 and accompanying text.

[239] HEMEL, HOLTZBLATT & ROSENTHAL, *supra* note 208, at 15 and accompanying text.

[240] *See* Melissa A. Dizdarevic, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967, 2984 (2011) ("FATCA is intended to fill these gaps by taking a more active approach to information reporting, and thus creating a better system of detection, with great penalties to act as deterrents.")

[241] See Niels Johannesen, Daniel Reck, Max Risch, Joel Slemrod, John Guyton, & Patrick Langetieg, The Offshore World According to FATCA: New Evidence on the Foreign Wealth of U.S. Households, Nat'l Bureau Econ. Rsch., Working Paper No. 31055, p. 31 2023), https://www.nber.org/papers/w31055 ("Given the magnitude of offshore wealth we observe under FATCA reporting, an important determinant of the overall effect of FATCA reporting will be the voluntary compliance effect on those owners who maintained their offshore accounts after FATCA implementation.").

[242] *See* Joel Slemrod, *Tax Compliance and Enforcement: New Research and its Policy Implications* 20 (Univ. Mich. Ross Sch. Bus., Working Paper, Paper No. 1302, 2016).

is the fact that, in the wake of these changes, many taxpayers participated in the country's Offshore Voluntary Disclosure Program.[243]

C. *Formulating the "Right Questions"*

Anytime there is a vast noncompliance problem, there are several ways that Congress and the IRS can seek remediation. The nation's legislative body can enact legislation designed to curb tax noncompliance. To illustrate, approximately a decade ago, Congress added section 7701(o) to the Code, mandating that for a transaction to be respected it must have economic substance.[244] The IRS can also launch audit projects in which certain segments of the economy come under heightened scrutiny.[245] For example, the IRS has launched an investigation into credit cards issued to U.S. customers by banks in alleged tax haven countries.[246] Such targeted responses to taxpayer noncompliance are no doubt productive, but taxpayer noncompliance statistics clearly show their limitations.[247]

Congress and the IRS should therefore try alternative approaches to foster tax compliance. One proven compliance methodology has been strategic question utilization. As demonstrated by the case studies previously presented and as measured by the billions of dollars of additional tax revenue that have been collected, the achievements of this methodology are uncontroverted.[248] Further, the administrative cost to the IRS in asking pertinent questions and in taxpayers responding to such questions is minimal.[249] Thus, compliance gains would only need to be marginal to justify this approach.

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[243] *See, e.g.*, Christian Hodgson, *On the Effort to Discover and Eliminate Offshore Tax Abuse*, 4 BUS. ENTREPRENEURSHIP & TAX L. REV. 170, 179 (2020) ("Congress projects annual tax revenue to increase by $250 million as a result of taxation on previously-untaxed offshore assets.").

[244] *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, sec. 1409, § 7701(o), 124 Stat. 1029, 1067–68 (2010).

[245] *See, e.g.*, Nicole Occhuizzo, *Achieving Success in a Worker Classification Audit*, 85 PRAC. TAX STRATEGIES 196, 196 (2010) ("In the first quarter of 2010, the IRS kicked off the Employment Tax National Research Project, a large-scale employment tax audit program that will focus heavily on worker classification. Under this new program, the IRS will audit 6,000 randomly selected businesses over the next three years—in addition to those businesses selected for worker classification audits under the IRS's general audit program—to determine whether workers treated as independent contractors have been properly classified as such.").

[246] *See, e.g.*, INTERNAL REVENUE SERV., FS-2002-12, IRS SETS NEW AUDIT PRIORITIES (Sept. 2002), https://www.irs.gov/pub/irs-news/fs-02-12.pdf [https://perma.cc/U224-YWW3] (describing, among other projects, the "Offshore Credit Card Project").

[247] U.S. GOV'T ACCOUNTABILITY OFF., GAO-23-106448, TAX GAP: MODEST REDUCTIONS IN THE GAP COULD YIELD LARGE FISCAL BENEFITS 1 (2023).

[248] *See* Dubner & Levitt, *supra* note 123.

[249] *See generally* Thomas, *supra* note 62.

One obvious place to consider expanding question use is where tax compliance is lowest. However, this does not suggest simple solutions because, as discussed above, tax compliance is often lowest where verifiable information is lacking.[250] Thus, the IRS should consider two approaches to strategic tax return questions: (1) where verifiable information can readily be solicited, a tax return form should raise questions that will yield such data; and (2) absent the solicitation of easily verifiable information, a tax return form should raise questions that will require taxpayer responses coupled with a message that acts of commission will be met with steep punishment. The Appendix includes an example of Form 1040 with the following types of questions included, to illustrate one way in which the IRS could proceed.[251]

1. *Illustrations of Questions That Secure Verifiable Information*

As already posited, the solicitation of information that the IRS can readily confirm greatly enhances tax compliance.[252] An example is the IRS's request for dependents' Social Security numbers. The IRS should continue to capitalize on this approach in the realms of (i) virtual currencies and (ii) foreign accounts.

a. *Virtual Currencies*

The IRS has already adopted the approach of asking "information-gathering" questions on Form 1040 in the realm of virtual currencies. Starting in 2020, Form 1040 asks all tax return filers the following "yes" or "no" question:[253]

> At any time during 202[x], did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?

A few observations are in order. First, the question is now on the front of Form 1040 (near the top), rather than on a schedule following Form 1040.[254] This is an ideal placement because it forces taxpayers to answer the question regardless of whether they fill out any of the schedules. Its prominent location

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[250] *See* INTERNAL REVENUE SERV., *supra* note 26, at 13.

[251] In the interest of being concise and saving space on Form 1040, we propose that all of these questions be grouped together in one prominent place on the front of the form, with a reminder of the potential penalties for failure to answer accurately.

[252] *See* INTERNAL REVENUE SERV., *supra* note 26, at 13.

[253] *See* Gray-Fenner, *supra* note 3 ("The IRS really wants to know about your cryptocurrency. For tax year 2020 the IRS moved the cryptocurrency question from Schedule 1 of the Form 1040, where it was in 2019, to the much more prominent position of Page 1 of the Form 1040 itself. The question is the second piece of information requested, right after the taxpayer's name and address.").

[254] *See id.*

may also signal to taxpayers that the IRS is paying close attention to the answer, encouraging the perception that there may be consequences to responding untruthfully. Further, it is significantly harder for taxpayers to claim that they inadvertently failed to report virtual currency transactions because they did not know they were taxable given the question's prominent placement. Importantly, the "yes" or "no" frame of the question forces taxpayers to respond—an act of commission—rather than simply not reporting income from cryptocurrency transactions elsewhere on the return (an omission). Finally, the information is at least potentially verifiable with third-party information,[255] and probably perceived so by taxpayers, making the question unlike the foreign bank account question in the pre-FATCA days when taxpayers likely thought that they would never get caught for their dishonesty. Thus, the virtual currency question, a relatively new addition to Form 1040, presents a compelling model for future, additional tax return questions.

b. *Foreign Accounts*

The IRS already has a tax return question in place about foreign accounts, which reads as follows:

> At any time during 202[X], did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?[256]

Going forward, this question should prove far more useful now that the IRS has third-party information about foreign accounts via FATCA. Like the virtual currencies question, the question elicits a "yes" or "no" response that requires an act of commission. For many decades, the response to this question was largely unverifiable.[257] However, due to introduction of FATCA, this is no longer the case. Instead, in most instances, the IRS can now cross-check the veracity of a taxpayer's response.[258]

The IRS should make one modest alteration to the foreign account question in order to give it a more prominent placement. Currently, the question is found on Schedule B of Form 1040.[259] Like the virtual currency question, placing the foreign account question on the front of the 1040 would

[255] Starting in 2023, cryptocurrency exchanges must report transactions on Form 1099-B, and businesses that accept cryptocurrency payments of $10,000 or more must also report the payment to the IRS. *See, e.g.*, *2023 IRS Cryptocurrency Reporting Requirements*, STRAUSS TROY (Mar. 10, 2022), https://www.strausstroy.com/articles/2023-irs-crypto-reporting/ [https://perma.cc/Q59W-PBFC]

[256] INTERNAL REVENUE SERV., *supra* note 232.

[257] *See* Blum, *supra* note 204, at 595.

[258] *See* Kudrle, *supra* note 207, at 147.

[259] INTERNAL REVENUE SERV., *supra* note 232.

force taxpayers to answer it even if they did not fill out schedules; and, more importantly, this placement would send a signal to taxpayers of the question's importance. The Appendix offers an example of placement of this question on the front of Form 1040.[260]

2. *Illustrations of Questions That Secure Information Not Readily Verifiable*

Along with securing readily verifiable information, the IRS should solicit information that is not readily verifiable but that nevertheless puts taxpayers on notice that their acts of commission may be subject to punishment. The IRS should capitalize on this approach in three realms: (a) unreported cash and cash equivalents, (b) household employees, and (c) tax shelters.

a. *Unreported Cash and Cash Equivalents*

Cash-based businesses present challenges due to the lack of easily verifiable information.[261] However, it is precisely due to the lack of substantial third-party reporting in these areas[262] that the use of strategic questions could provide an important compliance tool to the IRS. In the case of cash and cash-equivalent income, the IRS could consider two different approaches, as alternatives or in conjunction with one another.

First, the IRS could simply pose a "yes" or "no" question near the top of Form 1040 akin to the virtual currency question. For example, the question might read as follows:

> At any time during 202[X], aside from income reported on Form W-2 or Form 1099, did you receive any business-related cash or cash-equivalent payments (e.g., checks/virtual currencies/payment apps such as Venmo)?

Such a question would make salient to the taxpayer the fact that the IRS is paying attention to cash/cash-equivalent income and would require an immediate act of commission. Further, the question would immediately highlight for the IRS which taxpayers earn business income that might not be reflected on Form 1099, allowing the agency to better target its enforcement activities. Taxpayers, too, are not entirely oblivious that the answer to this question is at least somewhat verifiable, albeit not as readily cross-checked as is the case regarding the receipt of a Social Security number (e.g., upon audit, the IRS could presumably identify whether the taxpayer had deposited business-related checks into a bank account or spent sums of money in excess of what the taxpayer reported for tax purposes).

[260] *See infra* App.: An Example of Form 1040 with Questions.
[261] *See, e.g.*, Morse, Karlinsky & Bankman, *supra* note 15.
[262] *See id.*

Beyond this "gatekeeper" kind of question (i.e., whether a particular taxpayer's return might be subject to heightened scrutiny), the IRS could also ask follow-up questions that solicit specific information on the dollar magnitudes of these transactions. Such questions might be as follows:

> If you answered yes, how much did you receive? (Do not include any amounts that were reported on Form W-2 or Form 1099.)
>
> If you answered yes, how much of these payments did you deposit in financial institutions or hold in cryptocurrency?

Raising these questions might yield mixed results. On the one hand, asking for dollar numbers allows taxpayers more freedom to report dishonestly, particularly if they perceive that the IRS will not be able to verify the number. On the other hand, asking a pointed and specific question about cash income might cause taxpayers to feel compelled to report more honestly because such a question requires a clear act of commission.[263]

b. *Household Employees*

By its very nature, any IRS direct monitoring of whether taxpayers were employing household employees would likely be deemed highly intrusive and politically intolerable.[264] That being the case, historically, the IRS has rarely sought to attain verifiable information regarding whether taxpayers are being forthright in their reporting practices insofar as household employees are concerned.[265] But simply asking the following "yes/no" question can place taxpayers in a compromised position if they choose to lie:

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[263] A natural follow-up issue regarding these questions is upon which tax returns should they appear in the case of businesses conducted through entities. In the United States, business enterprises are traditionally organized through three mediums: sole proprietorships, partnerships, and corporations. Given this, it would be entirely appropriate for questions for business entities to appear on Form 1065 ("U.S. Return of Partnership Income") and Form 1120 ("U.S. Corporation Income Tax Return"). For taxpayers conducting businesses through sole proprietorships, information-gathering questions would best appear on Schedule C ("Profit or Loss from Business"). Since the majority of business enterprises are conducted in these three manners, virtually all taxpayers involved in business would have to respond. *See, e.g.*, Diane Lupke, *Alternative Business Strategies for the Fourth Industrial Revolution*, 30 J. MULTISTATE TAX'N & INCENTIVES 14, 16 (2020) ("There are three main forms of business organization: sole proprietorships, partnerships, and corporations, with some variations on each form. According to the Tax Foundation, in an article dated September 4, 2019, there are nearly 23 million sole proprietorships (not counting single-owner farm businesses), 1.7 million C corporations, and 7.4 million partnerships and S corporations in the United States.").

[264] *See* Blum, *supra* note 204, at 603–06.

[265] ERARD, *supra* note 200, at 206.

> In 202[X], did you pay any individual household worker (e.g., health-care aid/childcare provider) $2,600 or more?[266]

In responding to this question, taxpayers would have a binary choice. On one hand, if they are honest and had hired household employees, they would know that they were then responsible for the completion of Schedule H; on the other hand, if taxpayers lied, they would be committing fraud via an act of commission on their Form 1040.

c. *Tax Shelters*

Historically, the IRS has found it challenging to detect taxpayer tax shelter utilization.[267] The reason for this failure is that taxpayers often have successfully masked their tax shelter use by not reporting the huge losses they generate; instead, they report moderate amounts of income that can then pass audit muster.[268] How do taxpayers achieve this seeming alchemy? They amalgamate their gains with the tax-shelter-generated artificial losses.[269] In the face of this chicanery, a Form 1040 question might thus ask a "yes" or "no" question designed as follows:

> In 202[X], aside from transactions in publicly held stock and securities, did any investment you made or business venture you engage in yield recognized losses in excess of $500,000?[270]

If the taxpayer responded "yes" to this question, a follow-up question to give the IRS additional information on the scope and magnitude of such losses would be as follows:

> If you answer yes, what was the aggregate amount of such losses?

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[266] The $2,600 figure is the triggering reporting threshold. *See Employment Taxes For Household Employees*, INTERNAL REVENUE SERV. (Apr. 7, 2023), https://www.irs.gov/taxtopics/tc756 [https://perma.cc/DLE3-YSJE].

[267] *See* Patricia B. Hsue, Comment, *Lessons from* United States v. Stein*: Is the Line Between Criminal and Civil Sanctions for Illegal Tax Shelters a Dot?*, 102 NW. U. L. REV. 903, 915 (2008) ("Because tax shelters are difficult to define and identify, Congress, the Treasury Department, and the IRS face a challenge in designing and implementing effective laws and regulations.").

[268] *See generally* Burke & McCouch, *supra* note 221.

[269] *See generally id*.

[270] The $500,000 threshold is simply illustrative. Even so, due to limited IRS resources, there are only so many tax returns that the agency can audit, and $500,000 (or some other relatively high-dollar figure) would help the IRS differentiate ordinary losses that taxpayers might experience from extraordinarily losses generated by tax shelter use; in addition, given the administrative costs associated with tax shelter establishment (e.g., lawyer and accountant fees), most taxpayers will probably only participate in them when the financial upside is significant.

With this information in hand, as skeletal as it is, the IRS would be in a far better position to decide whether an audit of the taxpayer's tax return might prove worthwhile.

3. *Overall Impact of Information-Gathering Questions on Form 1040*

Regarding the merits of putting information-gathering questions on the face of Form 1040, the IRS could further strengthen the psychological power of raising these questions by informing taxpayers that they must complete the answers to these questions and also reminding taxpayers of the penalties associated with false reporting.[271] For example, the IRS could include the following statement:

> Completion of these questions is required, and failure to accurately answer these questions may subject you to civil and/or criminal penalties.[272]

Regarding this statement's impact, some taxpayers would no doubt become more compliant, fearful that their deceit could result in tax penalties and charges of criminality, while other taxpayers would still deliberately lie and answer the questions dishonestly.[273]

Compared to the current system, however, there is every reason to believe that strategic questions will prove impactful. By way of example, suppose Mr. Smith is a salaried employee by day, but moonlights as a painter. Further assume that Mr. Smith, who takes payments via cash and checks for his side gig, earned $60,000 painting homes last year. He considers these payments to be tax-free gratuities, and, in prior years, he has never reported them. As a practical matter, the IRS would have a difficult time ascertaining the derelictions surrounding Mr. Smith's tax-reporting practices. Under the current system, Mr. Smith can simply report his W-2 wages on his Form 1040 and conveniently "forget" to report his earnings from painting.

In the face of pointed tax return questions, however, Mr. Smith faces a dilemma. If he answers "no" to a "yes/no" question asking him about whether

[271] This feature would be akin to the letters sent to taxpayers in the successful Dominican Republic tax experiment. See the earlier discussion and notes. *See* Holz, List, Zentner, Cardoza & Zentner, *supra* note 62, at 3, 14–15 and accompanying text.

[272] An example is included in the Appendix. This statement is somewhat similar to the standard statement found at the end of Form 1040, which states that "[u]nder penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete." *See* INTERNAL REVENUE SERV., *supra* note 1, at 2.

[273] Regarding this latter set of taxpayers, the IRS could double down on its efforts to conduct comprehensive audits, penalize offenders, and bring its enforcement activities to the public's attention via public shaming of the offenders. *See, e.g.*, Darren Azman, *Don't Tell Mom I Didn't Pay My Taxes!: The Efficacy of State Shaming Campaigns on Taxpayer Compliance and Ideas for the Future*, 63 TAX LAW. 1251, 1267–69 (2010) (explaining the relative success state tax authorities have enjoyed in publicly shaming tax scofflaws).

he earned cash or cash-equivalent business income, he has committed a clear act of commission by reporting falsely on his tax return.[274] He may rationally fear that the potential penalty for this violation is more serious than simply "forgetting" to report the income on top of his wages. He may also rationally fear that the IRS will seek to verify the accuracy of his answer. Indeed, the recent Dominican Republic study indicates that taxpayers are significantly more compliant when they are prompted to make an active choice and reminded of penalties for dishonest reporting.[275] A similar calculus would likely apply with respect to information-gathering questions, such as asking Mr. Smith how much in business-related checks he deposited or converted into cryptocurrency.[276]

In sum, the aforementioned questions attempt to level the information playing field. Among other things, they seek to compel taxpayers such as Mr. Smith to reveal exactly how much cash and cash equivalents he received and thereafter deposited, retained, or held. Furthermore, such questions would provide a strategic vantage point for the IRS, enabling the agency during subsequent audits to more accurately determine whether taxpayers were forthcoming in their reporting practices.

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[274] *See* I.R.C § 7206(1).

[275] *See* Holz, List, Zentner, Cardoza & Zentner, *supra* note 62, at 3.

[276] One possible refinement to these questions would be to limit their application to those taxpayers that are somewhat smaller in size (for example, gross receipts below a certain dollar threshold). For example, accrual accounting, rather than cash accounting, is only mandated for business enterprises whose gross receipts exceed a particular dollar threshold. *See* I.R.C. § 448(c)(1) ("A corporation or partnership meets the gross receipts test of this subsection for any taxable year if the average annual gross receipts of such entity for the 3-taxable-year period ending with the taxable year that precedes such taxable year does not exceed $25,000,000."). Arguably, large businesses have more oversight from various actors, including, but not limited to, independent accountants and employees who would be far less inclined to conspire if they did not share in the financial bounty. In addition, each additional conspirator has an incentive to divulge compromising taxpayer information to the IRS in hopes of securing a financial award. *See* I.R.C. § 7623(a)–(b) (awarding taxpayers who reveal those individuals or corporations that have deliberately underreported or underpaid their taxes to the IRS). Furthermore, with every additional conspirator added to the collaborative tax-evasion scheme, the risk of noncompliance disclosure becomes enhanced. *See, e.g.*, William S. Cohen, *Congressional Oversight of Covert Actions: The Public's Stake in the Forty-Eight Hour Rule*, 12 HARV. J.L. & PUB. POL'Y 285, 297 (1989) ("No one disputes the assertion that the risk of disclosure increases with every additional person who is given knowledge of a particular covert action."). However, notwithstanding potentially lower tax noncompliance risks associated with larger businesses, such businesses also have the financial resources to readily capture the information that these questions raise, so the institution of this reform should remain universal in nature to all taxpayers.

D. *Concerns Associated with Tax Form Questions*

There are several possible concerns that might arise regarding these types of tax form questions. Three in particular would be as follows: (1) questions of this nature would be too intrusive, (2) responding to these information requests would be too labor- and resource-intensive to justify their existence, and (3) questions of this nature would not boost compliance enough to justify their existence. Consider the legitimacy of each.

1. *Question Intrusiveness*

As a general matter, taxpayers harbor severe misgivings about the government prying into their financial affairs.[277] For example, the IRS recently sought to have banks report the amount of money flowing into and out of accounts, with breakdowns for foreign transactions and transfers to the same account holder.[278] The original $600 reporting threshold received significant pushback from the finance industry and from many politicians, who claimed that the so-called Big Brother (the IRS) was going to be examining virtually every single banking transaction that taxpayers undertook.[279] To

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[277] Blum, *supra* note 204, at 603–06. When the IRS suggested the use of facial recognition to verify information, there was a public uproar; the IRS then retreated from this idea. *See* I.R.S. News Release IR-2022-27 (Feb. 7, 2022) ("'The IRS takes taxpayer privacy and security seriously, and we understand the concerns that have been raised,' said IRS Commissioner Charles Rettig. 'Everyone should feel comfortable with how their personal information is secured, and we are quickly pursuing short-term options that do not involve facial recognition.'").

[278] *See* DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2022 REVENUE PROPOSALS 88 (2021), https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf [https://perma.cc/87PL-4H5K]("This requirement would apply to all business and personal accounts from financial institutions, including bank, loan, and investment accounts, with the exception of accounts below a low de minimis gross flow threshold of $600 or fair market value of $600.").

[279] *See* Elizabeth Bauer, *Here's Why, Actually, The IRS $600 Bank Reporting Proposal Is Entirely Reasonable*, FORBES (Oct. 16, 2021), https://www.forbes.com/sites/ebauer/2021/10/16/heres-why-actually-the-irs-600-bank-reporting-proposal-is-entirely-reasonable/?sh=6e704e6b843b [https://perma.cc/A2EF-XMK6] ("At the Heritage Foundation, a commentary claims that this change would be "invading your privacy and putting more of your financial data at risk," citing past leaks at and politicization of the IRS. A group of 40 banking/credit industry organizations likewise objected that Americans' financial privacy was at risk and claimed that this new requirement would deter unbanked households from establishing accounts. And other politicians, as cited in fact checks, mischaracterizing the proposal, claim that it would result in the IRS examining the particulars of every $600 transaction.").

address these concerns, the IRS raised the bank-reporting threshold to $10,000 (not counting wage and salary deposits).[280]

However, consider the legitimacy of taxpayers' privacy concerns insofar as their business transactions are concerned. The dictionary defines *commercial* to mean "occupied with or engaged in commerce,"[281] and one common dictionary definition of *commerce* is "social intercourse: interchange of ideas, opinions, or sentiments."[282] The takeaway regarding the combination of both of these widely accepted definitions is that when it comes to commercial transactions or enterprises, taxpayers should generally not harbor any expectation of privacy.[283] To the contrary, by their very nature, business transactions are in the public domain—and, as such, they should not be subject to significant privacy concerns. Further, when it comes to foreign accounts or virtual currencies, taxpayers would not be asked to reveal any private-sphere information, such as for what purpose they hold their accounts or on what items they have spent funds in their accounts. Rather, they would simply be asked to reveal nonprivate information that is already required to be reported for tax purposes, such as the presence of taxable income sources. Simply put, taxpayers do not have a privacy interest in concealing income from the IRS.

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[280] *See* Irina Ivanova, *U.S. Treasury Amends Proposal to Track Nearly All Bank Accounts*, CBS NEWS (Oct. 22, 2021), https://www.cbsnews.com/news/irs-bank-account-update-change-treasury-10000-dollars/ [https://perma.cc/JJZ3-QR6Q] ("After initially proposing to track bank accounts with more than $600 of inflows or outflows, on the Treasury on Tuesday offered a new threshold. More than $10,000 in transfers in a given year would flag an account for reporting to the IRS, the agency said in a press release. Wage and salary deposits won't count toward that threshold, the Treasury said.").

[281] *Commercial*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/commercial [https://perma.cc/82LY-52B9].

[282] *Commerce*, MERRIAM-WEBSTER, https://www.merriam-webster.com/dictionary/commerce [https://perma.cc/Y64V-VU9U].

[283] *See, e.g.*, Alexandra Coulter, *Drug Couriers and the Fourth Amendment: Vanishing Privacy Rights for Commercial Passengers*, 43 VAND. L. REV. 1311, 1316 (1990) ("Fourth amendment jurisprudence in the transportation context suggests that there is little or no reasonable expectation of privacy during travel via commercial transportation."); *see also* Lisa J. Zigterman, *Live and Let Drive: The Struggle for Unauthorized Drivers of Rental Cars in Attaining Standing to Challenge Fourth Amendment Searches*, 2009 U. ILL. L. REV. 1655, 1661 (2009) (quoting New York v. Burger, 482 U.S. 691, 700 (1987)) ("Under the Fourth Amendment, property used for commercial purposes is treated differently from purely residential property. Guests on the premises for commercial purposes, as in *Minnesota v. Carter*, have a lesser expectation of privacy. While admitting that individuals still may have an expectation of privacy in commercial property, Justice Blackmun noted that '[a]n expectation of privacy in commercial premises, however, is different from, and indeed less than, a similar expectation in an individual's home.'").

2. *Administrative Burdens*

As a practical matter, any administrative burden that Congress and the IRS place on taxpayers should strike a balance between trying to make the tax system more efficient and not causing undue labor-intensive hardships.[284] This balance is not always easy to achieve. Grant too much leeway to taxpayers, and tax noncompliance may blossom; burden taxpayers with too many administrative compliance responsibilities, and they may become resentful about fulfilling their civic duties.

As previously pointed out, over the last several years, computer software has streamlined the tax return–filing process.[285] This has opened the door for Congress and the IRS to institute other measures—such as raising important questions in the quest to secure greater taxpayer compliance.[286] Again, the use of these questions remains relevant even in the absence of the new computer software, but the case for these questions is strengthened by the presence of this new technology. By way of example, because tallying the receipt and subsequent deposit of cash and cash equivalents is not particularly onerous, the proposed questions posited above could be added to all tax returns with little burden imposed. Similarly, gatekeeper questions—such as asking taxpayers whether they earned overseas or entity income—are easy for taxpayers to answer.

3. *Uncertainty over Efficacy*

Finally, a fair critique of these questions may be that some taxpayers will continue to lie, failing to enhance compliance to a significant degree. A further and related critique is that the addition of too many tax return questions might dilute their effectiveness.

As to overall efficacy, tax return questions are, of course, not a panacea. However, they cost almost nothing to implement and for that reason can be justified by even a modest bump in compliance.[287] Further, as discussed at length earlier, both research and experience demonstrate that the mere act of asking these questions can contribute to taxpayers' honesty and can also provide relevant information to the IRS, even in the absence of verifiable

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[284] A constant refrain among academics and politicians is to institute those proposals that are sensitive to the need to strike this balance. *See, e.g.*, Pomy Ketema, Note, *Did the Federal Check-the-Box Regulations Open Up a State Tax Pandora's Box? A Reflection on State Conformity to the New Federal Classification Scheme of Single-Member LLCs*, 82 MINN. L. REV. 1659, 1661–62, 1688–94 (1998) (advocating a reform measure designed "to implement a taxing scheme that will strike a balance between the needs of taxpayers in meeting their tax burden and the needs of the state in collecting adequate revenue with greater administrative efficiency").

[285] See sources cited *supra* note 159.

[286] Alm, *supra* note 18, at 335.

[287] Thomas, *supra* note 62, at 669–70.

third-party information and even without expensive and time-consuming audits.[288] Finally, regardless of whether the IRS has the capacity in a given year to target for audit all respondents to a particular question, the mere presence of these questions should enhance compliance and deter cheating.[289] In terms of the concern that the addition of too many questions may detract from their effectiveness, this Article is not suggesting that an avalanche of questions be added but rather that a limited number of strategic questions (say, five) be posited.

This subpart illustrated the power of the "right" questions to galvanize tax compliance. By no means is the list of questions exhaustive. Where taxpayer compliance is known to be lackluster, other questions could be used to enhance the collection of taxes. For example, one question might be: "Over the course of the prior year, did you write checks made payable to cash that equaled or exceeded $10,000 to pay for household help?"[290] Another question could be used to detect personal expenses camouflaged as being business in nature: "If you deducted automobile expenses related to your business enterprise, what is the percentage of your personal versus business use of your vehicle?"[291] Many risk-averse taxpayers will respond honestly to these questions; admittedly, others will not. However, even regarding the latter set of taxpayers, responses to these questions will position the IRS, during the course of a tax audit, in a far stronger position to gauge the legitimacy of a particular taxpayer's reporting positions.

V. CONCLUSION

The current era is one dominated by data.[292] It is no surprise that the moniker "Information Age" appears to capture the essence of this century and

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[288] *See e.g.*, Dubner & Levitt, *supra* note 123.

[289] In a sense, well-designed tax return questions can play a role similar to that played by third-party information returns like Form 1099. The IRS does not, in fact, match all of those information returns with taxpayers' returns. But taxpayers still respond to them by reporting honestly, presumably because they believe that there is a significant likelihood of detection if they do not. Asking taxpayers to answer direct and probing questions could serve as a similar deterrent without even incurring the cost of third-party tax information returns.

[290] *See* Johnston, *supra* note 202.

[291] *See generally* James Alm & Jay A. Soled, *The Internal Revenue Code and Automobiles: A Case Study of Taxpayer Noncompliance*, 14 FLA. TAX REV. 419 (2013) (explaining the reasons why tax noncompliance insofar as business automobile use is so prevalent).

[292] *See, e.g.*, Tom Breur, *Big Data and the Internet of Things*, 3 J. MKTG. ANALYTICS 1, 3 (2015) ("This second wave of Big Data growth, triggered by large-scale application of machine-to-machine traffic, is more like a tsunami than a wave. Unstoppable and irreversible."); *see also* Liran Einav & Jonathan Levin, *The Data Revolution and Economic Analysis*, 14 INNOVATION POL'Y & ECON. 1, 1 (2014) ("The media is full of

perhaps even the entire millennium. Indeed, everywhere one turns, immense amounts of data are being generated and processed as essential elements in business.

The IRS should attempt to ride the current information wave and harness it. In the past, the agency's resources were often directed to overseeing data entry and checking mathematical computations.[293] Those days are now long over as computer software and electronic filing have all but eliminated these tasks.[294] Therefore, the IRS should work with Congress to focus on securing new data via the strategic use of questions that can strengthen and foster taxpayer compliance. This effort should be two-pronged in nature: capturing data that can be automatically cross-checked and attaining information that enables the IRS to conduct more thorough and more robust audits. In the process, taxpayers are likely to report more honestly when they are compelled to engage in acts of commission, and the IRS is likely to improve its ability to detect noncompliance.

Any analysis that lauds and trumpets the tactical use of questions should itself conclude with a question. An especially appropriate question is this: How quickly will Congress and the IRS heed the foregoing advice and capitalize upon all the information that strategically asked questions have to offer? The answer to this question, at present, remains unknown.

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reports about how big data will transform business, government, and other aspects of the economy.").

293 *See* Nancy Sieger, *Modernizing Tax Processing Systems,* INTERNAL REVENUE SERV. (July 28, 2022) https://www.irs.gov/about-irs/modernizing-tax-processing-systems [https://perma.cc/7R3S-UMCV].

294 Soled, *supra* note 23, at 372.

APPENDIX: AN EXAMPLE OF FORM 1040 WITH QUESTIONS

Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return 2022 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box.
☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name		**Your social security number**
If joint return, spouse's first name and middle initial	Last name		**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions.		Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ **You** ☐ **Spouse**
City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code	
Foreign country name	Foreign province/state/county	Foreign postal code	

Business-Investment Income & Expenses

Completion of these questions is required and failure to answer them accurately may subject you to civil and/or criminal penalties

In 2022, aside from income reported on Form W-2 or Form 1099, did you receive any business-related cash or cash-equivalent payments (e.g., checks/virtual currency/payment apps such as Venmo)? ☐ **Yes** ☐ **No**
If you answered yes, how much? (Do not include any amounts that were reported on Form W-2 or Form 1099.)
How much of these payments did you deposit in financial institutions or hold in cryptocurrency?

In 2022, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? ☐ **Yes** ☐ **No**
If you answered yes, specify the amounts: **Received** **Sold** **Exchanged**

In 2022, did you pay any individual household worker (e.g., health-care aide/childcare provider) $2,400 or more? ☐ **Yes** ☐ **No**
If you answered yes, you must complete Schedule H.

In 2022, did you have any financial interest in or signature authority over any financial accounts (bank accounts, securities accounts, or brokerage accounts) located in a foreign country? ☐ **Yes** ☐ **No**
If you answered yes, you must complete Part III of Schedule B.

In 2022, aside from transactions in publicly held stock and securities, did any investment you made or business venture you engage in yield recognized losses in excess of $500,000? ☐ **Yes** ☐ **No**
If you answered yes, what was the aggregate amount of such losses?

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1957 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1957 ☐ Is blind

Dependents (see instructions):
If more than four dependents, see instructions and check here ▶ ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Attach Sch. B if required.

Standard Deduction for—
- Single or Married filing separately, $12,550
- Married filing jointly or Qualifying widow(er), $25,100
- Head of household, $18,800
- If you checked any box under *Standard Deduction*, see instructions.

1	Wages, salaries, tips, etc. Attach Form(s) W-2				1
2a	Tax-exempt interest	2a		b Taxable interest	2b
3a	Qualified dividends	3a		b Ordinary dividends	3b
4a	IRA distributions	4a		b Taxable amount	4b
5a	Pensions and annuities	5a		b Taxable amount	5b
6a	Social security benefits	6a		b Taxable amount	6b
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐				7
8	Other income from Schedule 1, line 10				8
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶				9
10	Adjustments to income from Schedule 1, line 26				10
11	Subtract line 10 from line 9. This is your **adjusted gross income** ▶				11
12a	**Standard deduction or itemized deductions** (from Schedule A)	12a			
b	Charitable contributions if you take the standard deduction (see instructions)	12b			
c	Add lines 12a and 12b				12c
13	Qualified business income deduction from Form 8995 or Form 8995-A				13
14	Add lines 12c and 13				14
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-				15

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2022)