

Call for the Gradual Phase-Out of All Paper Tax Information Statements

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CALL FOR THE GRADUAL PHASE-OUT OF ALL PAPER TAX INFORMATION STATEMENTS

by

Jay A. Soled*

For nearly a century, tax information statements such as Form W-2s and Forms 1099 have dominated the tax administration process, ensuring taxpayer compliance and providing a mechanism for IRS oversight. The technological age of the Internet, however, has fundamentally transformed the availability of information, including critical tax data, to make it more readily accessible. On the basis of this accessibility, this analysis calls for the phase-out of paper tax information statements. Instead, tax data would be available at a secure IRS website that, with a few keystrokes, taxpayers could conveniently use to prepare their tax returns. Adoption of this proposal promises to create tremendous administrative efficiencies and greatly simplify the tax return preparation process.

I.	INTRODUCTION.....	347
II.	INFORMATION STATEMENT ISSUANCE AND ITS ROLE IN THE TAX ADMINISTRATION PROCESS	349
	A. <i>History of Information Statement/Return Issuance</i>	<i>350</i>
	B. <i>Overview of How the Current Information Statement/Return System Operates.....</i>	<i>352</i>
III.	TECHNOLOGY GRADUALLY ECLIPSING NEED FOR PAPER INFORMATION STATEMENT ISSUANCE.....	356
IV.	BENEFITS FLOWING FROM THE PHASE-OUT OF PAPER INFORMATION STATEMENT ISSUANCE.....	361
	A. <i>Taxpayers</i>	<i>361</i>
	B. <i>Third-Party Information Issuers</i>	<i>363</i>
	C. <i>Tax Return Preparers.....</i>	<i>364</i>
	D. <i>Government</i>	<i>366</i>

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V.	RAISING AND ADDRESSING POTENTIAL PROBLEMS ASSOCIATED WITH THE PHASE-OUT OF PAPER INFORMATION STATEMENTS.....	370
VI.	CONCLUSION.....	373

*[The information return] is regarded as the most important blank form in the whole process of collecting income tax. It will involve an almost endless amount of labor on the part of many thousands of employers throughout the country. . . .*¹

I. INTRODUCTION

For nearly a century, the issuance of tax information statements/returns such as Form W-2s and Form 1099s, furnished annually to taxpayers, has played a vital role in the administration of our nation's income tax system and in bolstering compliance. Study after study shows robust evidence for this proposition: when information statements are issued, taxpayer compliance is high; conversely, in the absence of information statement issuance, taxpayer compliance plummets.² There is little doubt that information statement issuance, coupled with the IRS's information return matching program, probably constitutes the single most important compliance mechanism ever devised to ensure the viability of the Internal Revenue Code (Code). Nevertheless, the time has come for Congress to phase out its existing information statement issuance requirement over the next several years.

At first glance, calling for the phase-out of the information statement issuance requirement appears to be nothing short of a backhanded means to

1. See *Income Blanks Distributed*, Wall St. J., Jan. 25, 1918, at 9 (bemoaning the introduction of information returns to the tax administrative compliance process).

2. See U.S. Gov't Accountability Office, GAO-08-266, *Tax Administration: Costs and Uses of Third-Party Information Returns* (2007), available at <http://www.gao.gov/new.items/d08266.pdf> (reflecting the effectiveness of information returns in ensuring taxpayer compliance); IRS Fact Sheet FS-2006-24 (Aug. 2006), available at <http://www.irs.gov/newsroom/article/0,,id=161511,00.html> (“[E]xperience shows that taxpayers are much more likely to report their income when they receive third-party notification of payments they received.”); U.S. Gen. Accounting Office, GAO/GGD-94-123, *Tax Gap: Many Actions Taken, but a Cohesive Compliance Strategy Needed*, at 5 (May 1994), available at <http://archive.gao.gov/t2pbat3/151585.pdf> (“Information returns are a proven way to promote compliance and help IRS find noncompliance.”); Michael C. Durst, Report of the Second Invitational Conference on Income Tax Compliance, 42 *Tax Law.* 705, 707 (1989) (“Computer-based enforcement techniques, relying largely on information returns filed by payers of wages, interest, dividends, and other items, have provided valuable benefits by virtually eliminating noncompliance with respect to important categories of income.”); see also Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 *Stan. L. Rev.* 695, 695 (2007) (“[T]hird parties are routinely used by the tax system to verify the bona fides of taxpayer claims in diverse contexts involving reimbursed amounts and other receipts.”).

subvert the Code and its administrability. But the truth is that while information statements have served an admirable purpose, they are a relic of the past. Instead, consistent with the existing state of technology, accurate and timely tax information should be delivered electronically, supplanting our anachronistic delivery system of paper tax information statements.

In a nutshell, when the government capitalizes upon existing technologies, here is a glimpse of what the future will undoubtedly look like: On or before January 31 following the end of a calendar year, responsible third parties that have traditionally issued paper information statements will instead electronically send pertinent tax information (e.g., employees' wages, withholding data, interest payments, and the amount of recognized gains and losses on marketable securities) to the IRS. The IRS will then store this information, encrypt it, and post it on the Internet. From a secure IRS website, using a personal identification number or PIN, taxpayers will access this information, review it, and then download it instantaneously onto their income tax returns.³ Clerical errors would become virtually nonexistent because transcription mistakes and information entry in the wrong return fields would be minimized. While data aggregation of the sort envisioned here would not generate a tax compliance utopia, it would be a tremendous step in the right direction.

In the parts that follow, this analysis outlines the specific details of this vision, its viability, and its salutary benefits relative to maintaining the status quo. In Part II, this analysis provides a short historical sketch of tax

3. Congressman Bill Foster has recently introduced legislation that, in many respects, mirrors this proposal. Congressman Foster's proposed legislation, labeled the Autofill Act of 2010, would require the IRS to allow taxpayers to visit the IRS website and gain electronic access to their personal tax data. See H.R. 5036, 111th Cong. (2010). In addition, the government has an analogue of this proposal already in place known as the Electronic Federal Tax Payment System (EFTPS). As described in testimony for the IRS Oversight Board, "EFTPS enables businesses, including clients of such agents, to view their tax account online via secure Internet connection. Clients can confirm that tax payments have been received by the IRS and posted to their account as soon as the day after the tax deposit due date." Streamlining Tax Administration: How the IRS Can Streamline Its Own Processes and Decrease Taxpayer Burden (Feb. 1, 2005) (statement of Tony Tullo, Director, Federal Compliance for Automatic Data Processing, Inc., on behalf of the National Payroll Reporting Consortium), available at <http://www.treas.gov/irsob/meetings/2-01-05/statement-nprc.pdf>.

In lieu of the proposal to eliminate paper information statements, several commentators have suggested that Congress adopt a "pay as you earn" system that relies on a series of withholding taxes to obviate the need for many taxpayers to file tax returns. See William J. Turnier, PAYE as an Alternative to an Alternative Tax System, 23 Va. Tax Rev. 205 (2003). Pay as you earn tax systems are commonplace in many other countries. William G. Gale & Janet Holtzblatt, On the Possibility of a No-Return Tax System, 50 Nat'l Tax J. 475 (1997).

information statement issuance and the important role it has played to ensure taxpayer compliance. Part III explores the viability of electronic tax data aggregation and how it is poised to eclipse the world of paper tax information statement issuance. Part IV sets forth numerous benefits that would flow both administratively and financially were the tax statement information process to move in this direction. Part V raises and addresses potential problems associated with the congressional adoption of this proposal. Finally, Part VI offers conclusions.

II. INFORMATION STATEMENT ISSUANCE AND ITS ROLE IN THE TAX ADMINISTRATION PROCESS

One of the most important mechanisms to ensure tax compliance under the Code has been the issuance of information statements combined with the issuance of information returns:⁴ the former are furnished to taxpayers to facilitate their tax return preparation process, informing them of wages produced, income earned, interest that is deductible, and gains and losses experienced; the latter contains the identical information but are submitted instead to the government, enabling it to cross-check the accuracy of taxpayers' tax return entries.⁵

The reason that the combination of information statement/return issuance is so effective is that taxpayers know that the government has a road map to their reported income, making attempts to mask or omit such earnings virtually impossible. By way of analogy, in ancient Egypt tax collectors used to measure the level of the Nile to determine the amount of taxes owed by farmers.⁶ This public measurement put farmers on notice that the

4. See, e.g., Jane G. Gravelle & Pamela J. Jackson, CRS Report for Congress: Major Tax Issues in the 111th Congress (2009):

The percentage of individual income tax that was underreported varied significantly depending on the degree of information reporting and whether or not withholding was required. For example, only 1.2% of the sum of wages, salaries, and tips was underreported, but 57.1% of nonfarm proprietor income was underreported. These data suggest that increased information reporting and withholding would reduce the tax gap.

5. See IRS Data Book, 2009, Publ'n 55B, tbl.14, at 37 (Mar. 2010) (for fiscal year 2009, the IRS received approximately three billion information returns, less than 2% of which were filed in a paper format).

6. Aristide Théodoridès, *The Concept of Law in Ancient Egypt*, in *The Legacy of Egypt* 291, 292 (J.R. Harris ed., 1971); see also Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 *Fordham L. Rev.* 1733, 1736 (2010) ("With information reporting, the government obtains information about the taxpayer's tax situation from a third

government knew with a fair degree of accuracy what that year's harvest had yielded and, therefore, the annual tax the government could levy.⁷

In the subparts below, this analysis (A) summarizes the history of information statement/return issuance and (B) provides an overview of how the tax information reporting system currently operates.

A. *History of Information Statement/Return Issuance*

Before attempting to revamp the existing information statement/return system, it is worthwhile to try to understand its historical origins and how Congress, over the past century, has shaped and expanded this system.

Congressional institution of information return reporting commenced in 1917 and applied to a broad array of payments, including interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments or other fixed or determinable gains, profits, and income of \$800 or more paid during the course of any taxable year.⁸ At the time, the Commissioner instructed payers to use Form 1099 to report the delivery of such payments⁹ (with respect to wages, Form W-2 did not come into existence until 1943 when Congress instituted a broad withholding system).¹⁰ At least one newspaper, the Wall Street Journal, greeted the introduction of this administrative taxpayer burden with a chilly reception.¹¹

Presumably finding that third-party wage reporting was a good mechanism to help ensure taxpayer compliance, Congress decided to capitalize upon the success of this nascent initiative. In the Revenue Act of 1921, Congress expanded the existing information return system to include brokers.¹² This new legislation required that, upon request, every broker must disclose to the government "such details as to the profits, losses, or

party and—equally important—the taxpayer knows that the government has the information.”).

7. Said somewhat differently, the entire process is reminiscent of the Christmas spirit and Santa Claus: with information returns in hand, the IRS knows exactly who's been "naughty" and who's been "nice."

8. War Revenue Act, Pub. L. No. 65-50, ch. 63, § 1211, § 28, 40 Stat. 300, 337 (1917). See Richard L. Doernberg, *The Case Against Withholding*, 61 *Tex. L. Rev.* 595, 599–603 (1982) (detailing the history of information returns and statements).

9. See *supra* note 1 ("The Commissioner of Internal Revenue has begun the distribution of 20,000,000 income blanks known as 'Form 1099.'").

10. Current Tax Payment Act of 1943, Pub. L. No. 78-68, ch. 120, 57 Stat. 126.

11. See *supra* note 1.

12. Revenue Act of 1921, Pub. L. No. 67-98, ch. 36, § 255, 42 Stat. 227, 269.

other information . . . as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.”¹³

In 1943 Congress added another wrinkle to information statement/return issuance. Beginning in that year, Congress instituted a wage withholding system.¹⁴ This new withholding system added another dimension of complexity to information statement/return issuance. More specifically, on a going-forward basis, Congress required employers to delineate the amount of wages withheld on the newly minted so-called Form W-2.¹⁵

Notwithstanding the initial flurry of activity surrounding information statement/return reporting, for the next four decades its scope and application remained relatively constant. However, in 1982 Congress took measures to greatly expand information reporting. In the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Congress required brokers to delineate on information statements/returns the gross proceeds generated from all securities and commodities transactions.¹⁶

In the last few years, Congress has again taken several important steps to expand the scope of information reporting. In 2008 it passed legislation embodied in Code section 6045(g) that required taxpayers to track investors’ tax basis in so-called “covered securities” and, upon the disposition of such securities, report taxpayers’ corresponding gains and losses.¹⁷ In 2010, it passed legislation embodied in Code section 6041(h) that requires businesses that pay any amount greater than \$600 during the year to

13. *Id.*

14. See *supra* note 10; see generally Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 *Buff. L. Rev.* 685 (1988/89) (explaining how the current withholding system allowed Congress to greatly expand the number of taxpayers subject to the income tax).

15. See *Employer Duty in Withholding Tax Explained*, *Chi. Daily Trib.*, June 12, 1943, at 23 (“Employers must provide each employé [*sic*] annually with a ‘Statement of Income Tax Withheld on Wages.’ This is form W-2, and must be delivered to employés [*sic*] on or before Jan. 31 of the next year.”).

16. Pub. L. No. 97-248, § 311, 96 Stat. 324, 600-01; see Joint Comm. on Taxation, *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982* (1982).

17. See *Emergency Economic Stabilization Act of 2008*, Pub. L. No. 110-343, § 403, 122 Stat. 3765, 3854–56 (beginning in 2011, requiring security basis reporting).

corporate providers of property and services to file an information report with each provider and with the IRS.¹⁸

When formulating tax policy pertaining to information reporting, Congress has taken technological advancements and innovations into account. For example, approximately a decade ago, Congress enacted legislation that sanctioned the voluntary use of electronic tax information statement issuance.¹⁹ Payers required to furnish Form W-2 are now authorized to do so electronically with respect to consenting payees,²⁰ as can payers required to furnish statements under Code sections 6041 through 6050T, such as Form 1099-DIV.²¹ To ensure that unwilling payees are not forced to accept the receipt of their information statements electronically, both Treasury Department regulations and IRS administrative notices have set forth detailed rules to safeguard against unscrupulous payers mandating that payees accept receipt of their information statements electronically rather than in paper form.²²

B. Overview of How the Current Information Statement/Return System Operates

Tax information statements/returns come in many varieties. Some relate to the receipt of wages (i.e., Form W-2); others relate to the receipt of investment returns such as interest (i.e., Form 1099-INT) and dividends (i.e., Form 1099-DIV). As pointed out in the prior subpart, the variety of tax information statements/returns that the government requires taxpayers to disseminate and to file has grown exponentially.²³ Indeed, as Congress tries to close the “tax gap”—the difference between what taxpayers owe and what

18. See Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9006, 124 Stat. 119, 855 (2010) (beginning in 2012, greatly expanding the scope of information reporting).

19. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, § 401, 116 Stat. 21, 40.

20. Reg. § 31.6051-1(j)(1).

21. General Instructions to Form 1099 pt. H (2005); IRS Notice 2004-10, 2004-1 C.B. 433.

22. For example:

The consent requirement . . . is not satisfied if the recipient withdraws the consent and the withdrawal takes effect before the statement is furnished. The furnisher may provide that a withdrawal of consent takes effect either on the date it is received by the furnisher or on a subsequent date. The furnisher may also provide that a request for a paper statement be treated as a withdrawal of consent.

Reg. § 31.6051-1(j)(2)(ii).

23. See *supra* Part II.A.

they actually pay²⁴—taxpayers can anticipate that tax information statement/return reporting will become more robust because politicians will seek to generate additional revenue without having to raise tax rates or broaden the tax base.²⁵

The time period by which taxpayers must issue tax information statements/returns varies. To enable taxpayers to complete their tax returns in a timely fashion (e.g., March 15 in the case of calendar year corporate taxpayers and April 15 in the case of individual taxpayers),²⁶ most forms of tax information statements must be issued to payees by January 31.²⁷ To enable the IRS to monitor taxpayer compliance, tax information returns are generally due to the agency by February 28 if submitted in paper form²⁸ or by March 31 if submitted electronically.²⁹

To ensure compliance with the foregoing rules, Congress has instituted an elaborate penalty system pertaining to the issuance of timely and accurate information statements to payees and tax information returns to the government. One set of penalties applies to payers, financial institutions, and brokers, requiring them to furnish on a timely basis accurate tax information statements to payees and clients; another set of penalties applies to payers, financial institutions, and brokers, requiring them to submit

24. The IRS estimates that the tax gap for 2001 (the latest year in which such an analysis was conducted) was \$290 billion. IRS News Release IR-2006-28 (Feb. 14, 2006), available at <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>.

25. The fiscal year 2008 and 2009 budgets both contained provisions that would expand the use of information reporting. James M. Bickley, CRS Report for Congress: Tax Gap and Tax Enforcement (2008); FY 2009 IRS Budget: Written Testimony Before the H. Comm. on Ways & Means (2008) (statement of Douglas H. Shulman, Commissioner of Internal Revenue). In recent congressional testimony, the IRS Commissioner targeted six new areas of information reporting:

Require information reporting for private separate accounts of life insurance companies; Require information reporting on payments for services to corporations; Require a certified Taxpayer Identification Number (TIN) from contractors; Require increased information reporting on certain government payments; Increase information return penalties; and Require information reporting on expense payments relating to rental property.

Filing Season and FY 2011 Budget Request: Written Testimony Before the H. Comm. on Ways & Means (2010) (statement of Douglas H. Shulman, Commissioner of Internal Revenue) [hereinafter Shulman Testimony 2010].

26. IRC § 6072(a), (b).

27. See, e.g., IRC § 6049(c)(2) (requiring the issuance of Form 1099-INT by January 31 to the payee).

28. See, e.g., Reg. § 1.6049-4(g) (requiring the submission of Form 1099-INT by February 28 to the IRS).

29. IRC § 6071(b).

accurate tax information returns on a timely basis to the government. The next two paragraphs identify the nature of each set of these penalties.

1. Penalties for Failing to Furnish Timely and Accurate Tax Information Statements to Payees

On or before January 31 following the end of a calendar year, payers, financial institutions, and brokers are generally required to furnish tax information statements to payees and clients.³⁰ A payer, financial institution, or broker that fails to meet this requirement or, alternatively, fails to include correct information (or omits required information) is generally subject to a penalty of \$50 per statement, up to a maximum of \$100,000 in any calendar year.³¹ Even more severe penalties apply if the failure to comply with the foregoing furnishing rules is due to a payer's, financial institution's, or broker's intentional disregard of these rules.³² Due to the importance associated with taxpayers having timely receipt of and accurate information on these statements, neither the making of prompt corrections nor the commission of de minimis mistakes excuses or eliminates the imposition of penalties connected with the furnishing of incorrect tax information statements.³³

2. Penalties for Failing to Supply Timely and Accurate Tax Information Returns to the Government

In general, on or before February 28 (or March 31, if filed electronically), payers, financial institutions, and brokers must submit information returns to the government.³⁴ A payer, financial institution, or broker that fails to meet this requirement or, alternatively, fails to include correct information (or omits required information) is generally subject to a

30. An important exception to this rule pertains to partnerships and the issuance of Schedule K-1s to partners. These schedules are due on or before the day on which the partnership return for that taxable year must be filed (with extensions). Reg. § 1.6031(b)-1T(b).

31. IRC § 6722(a), (b).

32. The penalty is \$100 per statement or, if greater, (i) 10% of the aggregate dollar amount of items required to be reported (other than under Code §§ 6045(b), 6041A(e), 6050H(d), 6050J(e), 6050K(b), or 6050L(c)); or (ii) 5% of the amounts required to be reported under Code §§ 6045(b), 6050K(b), and 6050L(c). IRC § 6722(c)(1).

33. H.R. Rep. No. 101-247, at 1385 (1989) (expressing congressional concern that taxpayers need accurate information statements if they are to complete their tax returns in a timely fashion).

34. See, e.g., IRC § 6071.

penalty of \$50 per return, up to a maximum of \$250,000 per calendar year.³⁵ If payers, financial institutions, or brokers inadvertently submit incorrect information returns, the Code provides a set of reduced penalties for prompt corrections.³⁶ Furthermore, if timely corrected (usually on or before August 1 of the calendar year in which the return is required to be filed), errors or omissions on a de minimis number of returns will not generate penalty imposition.³⁷

Evident from the emergence of the current compliance system, grounded heavily upon the submission and the matching of tax information statements/returns, is the government's extraordinary reliance upon it and its proven ability to bolster taxpayer compliance.³⁸ The government recognizes the pivotal importance of this system and has been willing to make significant investments to promote its modernization.

Consider that the IRS has instituted the Modernized e-File (MeF) system. This system provides "a single method for filing all IRS tax returns, information returns, forms, and schedules via the Internet."³⁹ A key component of the MeF system is the Modernized Tax Return Database (M-TRDB), which is "the authoritative store of accepted returns and extensions submitted through the MeF system."⁴⁰ The key reasons for the institution of these two interrelated systems are simple:

[T]o allow the IRS to collect more tax documents electronically and reduce the costs associated with the inefficiencies of paper documents and manual processing, while enhancing customer service and increasing availability of taxpayer information. Internet-based filing directly supports the goal of revolutionizing how taxpayers transact and communicate with the IRS.⁴¹

35. IRC § 6721(a).

36. IRC § 6721(b). For example, if a payer corrects the error or omission within thirty days after the due date, the amount of the penalty is \$15 per return, up to a maximum of \$75,000 in a calendar year. IRC § 6721(b)(1).

37. IRC § 6721(c).

38. See *supra* note 2.

39. See Treasury Inspector Gen. for Tax Admin., 2009-20-026, *The Internal Revenue Service Deployed the Modernized e-File System with Known Security Vulnerabilities*, at 1 (2008), available at <http://www.treas.gov/tigta/auditreports/2009reports/200920026fr.pdf>.

40. *Id.*

41. *Id.*

To develop, operate, and maintain the MeF system, the projected costs are \$673 million.⁴² There is little doubt that the MeF system constitutes a worthwhile investment; however, it addresses only one-half of the information statement/return equation, leaving untouched the part that pertains to the issuance of paper information statements.⁴³ Additional dollars should clearly be devoted to develop the MeF system not only to accept and store information returns but also to use similar technology to allow taxpayers access to this stored data. Enabling taxpayers to gain access to this stored data would obliterate the need for third parties to issue paper tax information statements.

In the next part, this analysis documents how existing technology provides a sufficient platform to phase out the issuance of tax information statements in a paper medium.

III. TECHNOLOGY GRADUALLY ECLIPSING NEED FOR PAPER INFORMATION STATEMENT ISSUANCE

Over the last several decades, massive strides have been made in the field of technology. Compared to their predecessors of only a generation ago, computers can operate at much faster speeds and store much more information on their hard drives. Indeed, a contemporary computer can now complete in a matter of split seconds a process that may have taken several minutes a decade ago.⁴⁴ Along with a car and a telephone, a personal computer has become one of the most important durable items found in the average person's home.

42. *Id.*

43. Through its Electronic Tax Administration Advisory Committee, the IRS seems to be exploring ways to expand the use of computer applications to the tax filing process. Nevertheless, there are apparently no plans to make tax data available to taxpayers electronically such that they could complete the submission of their tax returns on a timely basis. IRS Publ'n 3415, Elec. Tax Admin. Advisory Comm., Annual Report to Congress (2010), available at <http://www.irs.gov/pub/irs-pdf/p3415.pdf>. On at least one occasion, however, the IRS did consider providing taxpayers with access to collected tax data, but this effort was subsequently abandoned. See Treasury Inspector Gen. for Tax Admin., 2009-20-102, Changing Strategies Led to the Termination of the My IRS Account Project (2009), available at <http://www.treas.gov/tigta/auditreports/2009reports/200920102fr.pdf> ("The intent of the project was to develop a project that would provide taxpayers a means to securely view their tax account and return information online, as well as provide tools for self-service assistance.").

44. See, e.g., Gordon Moore, Cramming More Components onto Integrated Circuits, 38 *Electronics* 8 (1965) ("The complexity for minimum component costs has increased at a rate of roughly a factor of two per year.").

Corresponding to these massive strides in the technology field has been the spiraling popularity of Internet usage. Although the Internet celebrates no exact birth date, in 1969 the U.S. Department of Defense developed a small network of computers that could communicate with each other in the case of an emergency.⁴⁵ This intercomputer communication ultimately led to the genesis of the Internet.⁴⁶ Initially, the development of the Internet proceeded slowly as standards developed in message formats.⁴⁷ By the early 1990s, once these standards were developed, Internet usage grew at lightning speeds.⁴⁸ Today, its usage has become a staple of American culture.⁴⁹ People constantly turn to it for information and to communicate. Simply put, its presence has single-handedly reshaped how people conduct their businesses and orchestrate their personal lives.

The impact of technology and the power of the Internet can be readily seen and felt in the sphere of tax administration. Most significantly, taxpayers consider computers central to the tax return preparation and filing processes. And this is for good reason. By 2008, over 80% of households possessed a personal computer.⁵⁰ Many taxpayers use their personal computers to prepare their own tax returns using tax return preparation software⁵¹ and to submit their returns electronically.⁵² When taxpayers turn to professionals to prepare their returns, in the vast majority of cases, these professionals likewise use tax preparation software and submit the prepared tax returns electronically.⁵³

45. See generally Janet Abbate, *Inventing the Internet* (1999).

46. *Id.* ch. 1.

47. *Id.* ch. 5.

48. *Id.* ch. 6.

49. Wade Rowland, *Spirit of the Web*, ch. 32 (2006).

50. Over 57 Percent of American Homes Have Access to High-Speed Internet Service, *Articlet*, <http://articlet.com/article791.html> (last visited Sept. 13, 2010) (“The PC penetration in American homes has increased to 80.6% in 2008 from 77.9% the year earlier.”); Patrick Seitz, *Personal Computer Still Eludes a Fifth of U.S. Households; Cost Remains Biggest Factor*, *Investor’s Bus. Daily*, Jan. 9, 2004.

51. See U.S. Gov’t Accountability Office, GAO-09-297, *Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks* (2009) (“Individual taxpayers used commercial tax software to prepare over 39 million tax returns in 2007. . .”).

52. See U.S. Gov’t Accountability Office, GAO-09-640, *Tax Administration: Interim Results of IRS’s 2009 Filing Season* (2009) (reporting for the 2009 tax return filing season that 72% of returns were filed electronically); IRS Data Book, *supra* note 5, tbl.4, at 9 (reflecting the fact that the majority of individual, corporate, and partnership tax returns are now filed electronically).

53. John L. Guyton, Adam K. Korobow, Peter S. Lee & Eric J. Toder, *The Effects of Tax Software and Paid Preparers on Compliance Costs 2*, available at

For reasons relating to efficiency, this reliance upon tax preparation software is understandable. Companies producing this tax preparation software can readily keep such software up-to-date and debug any programming issues. Indeed, more than ever, necessary changes are being conducted over the Internet rather than via deliverable media such as CD-ROMs.⁵⁴

The power and speed of today's computers combined with the availability of the Internet's information has made the need for paper records increasingly obsolete. Evidence for this proposition abounds. Consider the fact that around tax season, most public libraries traditionally stocked IRS publications and tax returns for their patrons to use.⁵⁵ No longer: These staples in public libraries have all but disappeared. Consider, too, that the IRS would historically mail copies of income tax returns beginning in mid-January for individual taxpayers to complete. Now, in an attempt to save resources and to cut costs, the IRS only mails hard copies of the Form 1040 to those taxpayers who have not previously filed their returns electronically.⁵⁶

Consider, too, that the availability of online documents combined with the speed and low cost of advanced networks has fundamentally changed the way we store documents. Two primary technologies allow businesses and individuals such easy access to information. The first is the advent of the "intranet," which allows documents to be stored centrally but still be accessible to all granted appropriate access.⁵⁷ The second is the

<http://www.urban.org/UploadedPDF/1000802.pdf> (last visited Sept. 10, 2010) ("Over 85% of tax returns were prepared on a computer in 2003—97% of the 62% of returns paid by preparers and 66% of the 38% of returns prepared by taxpayers.").

54. Curt Finch, *The Benefits of the Software-as-a-Service Model*, *Computerworld* (Jan. 2, 2006), available at http://www.computerworld.com/s/article/107276/The_Benefits_of_the_Software_as_a_Service_Model.

55. See, e.g., Rev. Proc. 86-35, 1986-2 C.B. 596 ("No charge will be made to a bank, post office, public library or other organization for any quantity of forms and instructions intended for the convenience and use of the taxpayer, so long as such organization is not engaged in the preparation of tax returns for private gain.").

56. See, e.g., Shulman Testimony 2010, *supra* note 25, at 13 ("The IRS will generate savings by eliminating the non-mandated notice inserts; the automatic mailing of Form 1040, U.S. Individual Tax Return, tax packages; and the automatic mailing of business tax products."); Ed O'Keefe, *IRS to Stop Mailing Income Tax Forms*, *Washington Post* (Sept. 27, 2010) available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/27/AR2010092705058.html> (the IRS will stop mailing instructions and paper forms, saving the agency \$10 million annually).

57. See, e.g., Mohd Daud Norzaidi, Siong Choy Chong & Mohamed Intan Salwani, *Intranet Usage, Managerial Satisfaction and Performance Impact: An Empirical Analysis*, 3 *Int'l J. Bus. & Sys. Res.* 481 (2009).

standardization of the PDF file as the electronic format of choice.⁵⁸ With these two technologies in place, it has become commonplace for all computer users (particularly working for the same employer) to think of documents as easy to find and ready to transport.

The one element of tax administration that has stubbornly bucked the paperless trend is the issuance of paper tax information statements. If left unchecked, not only will paper tax information statement issuance continue into the foreseeable future, all indications are that the issuance of paper tax information returns will skyrocket.⁵⁹ Both recently passed legislation and proposed legislation call for more tax information statement issuance.⁶⁰ In practical terms, what does this mean? Taxpayers will remain anchored in their traditional ways when meeting with their tax return preparers, continuing to bring their old “shoeboxes” filled with a wide assortment of paper tax information statements.

By way of comparison, consider the fundamental transformation that has occurred in the sphere of business tax return completion. Many businesses now use business software packages such as Quickbooks that

58. Int’l Org. for Standardization, PDF Format Becomes ISO Standard (July 2, 2008), www.iso.org/iso/pressrelease.htm?refid=Ref1141.

59. See *supra* note 25; see also, e.g., U.S. Dep’t Treasury, General Explanations of the Administration’s Fiscal Year 2010 Revenue Proposals (2009) (“Any U.S. person, or any qualified intermediary, that forms or acquires a foreign entity on behalf of a U.S. individual . . . would be required to file an information return with the IRS regarding the foreign entity that is formed or acquired.”); U.S. Gov’t Accountability Office, GAO-09-238, Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements 37 (2009) (“To simplify the burden that the corporate exemption places on payers to distinguish payee’s business status and also provide greater information reporting, Congress should consider requiring payers to report payments to corporations on the form 1099 MISC. . . .”); Sam Goldfarb, Shulman Calls for Increased Information Reporting, 2009 Tax Notes Today 89-44 (May 12, 2008) (“IRS Commissioner Douglas Shulman on May 9 said he is ‘philosophically’ supportive of more information reporting, specifically mentioning a controversial plan to require banks to report credit and debit card transactions.”).

60. See, e.g., Housing Assistance Tax Act of 2008, Pub. L. No. 110-289, §§ 3000, 3091, 122 Stat. 2654, 2877, 2908 (introducing Code section 6050W, which requires that the gross amount of payment card and third-party network transactions be reported annually to participating merchants and the IRS). In recently released proposed regulations, the IRS details the information that must be included on the newly designated Form 1099-K. Information Reporting for Payments Made in Settlement for Payment Card and Third Party Network Transactions, Prop. Regs. §§ 1.6041-1, 1.6050W-1, 31.3406(b)(3)-5, 31.3406(a)-2, 31.3406(d)-1, 31.3406(g)-1, 31.6051-4, 301.6721-1, 301.6722-1, 74 Fed. Reg. 225 (proposed Nov. 24, 2009); Amy S. Elliot, Long-Awaited Proposed Credit Card Reporting Regs Released, 125 Tax Notes 961 (2009).

enable them, at the end of each year, to readily download information onto their business tax returns without the presence of actual paper records. This data downloading process is far easier, less time-consuming, and more accurate than reliance upon paper records, which are readily misplaced or from which the data is inaccurately transcribed onto the submitted tax return.

The good news for the tax administration process is that tremendous strides have been made in the sphere of mass data storage and data aggregation. These strides should enable taxpayers and the government to replicate what is already being done in other areas of data storage and apply these advancements to individual taxpayer return compliance.⁶¹ (This trend is being further propelled by the fact that mass electronic data storage is “green,” galvanizing political momentum, particularly among environmentalists.)⁶² Three examples of successful data aggregation immediately come to mind. The first, cited in the prior paragraph, is the ability of off-the-shelf software packages to gather pertinent data entries and to file these entries exactly where the business taxpayer instructs. A second example of data aggregation pertains specifically to tax information: even today, many financial institutions and brokerage firms post taxpayer data, pertinent to their individual clients, on their websites; using a PIN, taxpayers/clients can readily download this personal tax information directly onto their individual income tax returns.⁶³ A third and final example of data aggregation is the M-TRDB system (described in Part II.B), which currently stores all accepted returns and extensions.⁶⁴

In terms of tax administration, what the foregoing advancements indicate is that the government, in terms of technology, does not need to

61. See Mike Ashenfelder et al., *NDIIPP Models for Mass Data Transmission and Storage*, 57 *Libr. Trends* 541 (Winter 2009).

62. U.S. Dep’t Treasury, *Treasury Goes Green, Saves Green* (Apr. 19, 2010), <http://www.treas.gov/press/releases/tg644.htm> (“With Americans poised to celebrate the 40th anniversary of Earth Day this week, the U.S. Department of the Treasury today announced a broad new initiative to dramatically increase the number of electronic transactions that involve Treasury and millions of citizens and businesses, a move that is expected to save more than \$400 million and 12 million pounds of paper in the first five years alone.”); Dennis McCafferty, *Government Goes Green—Political Pressure, Shrinking Budgets Force Agencies to Be Energy-Efficient*, *VARBusiness* (Sept. 29, 2008), at G6.

63. See, e.g., American Century Investments, *TurboTax and TurboTax for the Web*, https://www.americancentury.com/customer_service/turbotax_help.jsp (“TurboTax software and TurboTax for the Web include the Instant Data Entry feature, that enables the automated import of 1099-DIV, 1099-B and 1099-R tax data directly from American Century Investments for your retirement and non-retirement accounts. Once imported, you can download this information directly into your TurboTax return.”).

64. See text accompanying *supra* note 40.

break new ground. That is, once the government gathers all the data sent electronically to it by third parties, it should house this information on one central website. The government would then grant taxpayers direct electronic access to this data warehouse, limited to their particular “storeroom” (i.e., where tax data pertinent to the completion of their personal tax returns would be housed). With a few keystrokes, taxpayers accessing this website would then be able to download this tax data directly onto their tax returns.

IV. BENEFITS FLOWING FROM THE PHASE-OUT OF PAPER INFORMATION STATEMENT ISSUANCE

If Congress were to phase out tax information statement issuance and to call for the availability of this same information electronically via an IRS website, numerous administrative benefits would arise. In terms of money, resources, and time, these administrative benefits would result in tremendous savings. In the subparts below, this analysis sets forth the benefits that would inure to (A) taxpayers, (B) third-party information statement issuers, (C) tax return preparers, and (D) the government.

A. Taxpayers

By way of background, taxpayers who receive information statements such as Form W-2s and Form 1099s are often flummoxed and overwhelmed by the data such information statements contain. Consider the face of Form W-2: It encompasses spaces for over twenty numerical entries. For the nontax professional, the receipt of Form W-2 can be a beguiling experience: a seemingly official document, arriving typically by mail, contains a broad array of numbers, some coded and some not coded. For those taxpayers who willingly undertake the challenge and complete their own tax returns, most find it difficult to know exactly where each numerical entry of the Form W-2 should be transcribed on their paper Form 1040 or exactly when (and if) their tax preparation software will prod them to enter the information proffered on the information statement. Likewise, when it comes to using the information contained on Form 1099, the same sense of uncertainty usually besets taxpayers, in particular regarding where certain numerical entries, such as qualified dividends, belong on their tax returns.

Aside from numeric complications surrounding the tax return preparation process, taxpayers harbor numerous other concerns as well. Do they have all of their information statements? Are the dollar figures and codes contained on their information statements correct? Will they be able to enter the data contained on these information statements correctly on their tax returns? Will turning over these information statements to their tax return

preparers jeopardize their privacy and possibly facilitate identity theft?⁶⁵ If they pay a tax return preparer to prepare their tax returns and to enter this data, how expensive will the concomitant fee be?

Many, if not all, of the taxpayers' fears and concerns articulated in the prior two paragraphs would be allayed if the data contained on paper information statements were available electronically on a secure IRS website. For starters, taxpayers would have new confidence that the numbers and codes that previously appeared on their paper information statements and are now made available electronically on the IRS website could be handled in a more comprehensive fashion. That is, the IRS website could allow taxpayers to double click data entries to prompt a substantive explanation of the dollar figure and/or code in question.⁶⁶ Furthermore, with the push of another key, the IRS website could presumably enable taxpayers to eliminate tax return guesswork by transferring relevant data directly onto their tax returns to the exact location where such data should be recorded.

Use of a secure IRS website would help address other taxpayers' concerns as well. For example, taxpayers could have confidence that their information statements would not be mailed to the wrong address, opened by unscrupulous mailroom personnel, or lost subsequent to their receipt. On their computer screens, taxpayers could view all tax data relevant to their tax returns. If taxpayers noticed that the information from a particular third-party information issuer was missing, they could contact the third-party information issuer in question; alternatively, if there was a putative mistake made by that third party, taxpayers likewise could contact the third party to request a correction of the erroneous information.

Adoption of this proposal would also probably alter the relationship that taxpayers share with their tax return preparer. Right now, for reasons of cost efficiencies, data entry for a significant number of paid-preparer tax returns is conducted overseas.⁶⁷ Not only does the transference of personal

65. See David J. Roberts, *Why Is Your Social Security Number on Those Information Returns?*, 2010 Tax Notes Today 36-9 (Feb. 24, 2010) (stressing the dangers associated with having taxpayers' Social Security numbers posted on the face of information statements).

66. Indeed, the IRS website could have a series of pop-ups to remind taxpayers that all income must be reported, including income earned in the form of cash. On the one hand, such pop-ups could be a tremendous taxpayer compliance tool; on the other hand, taxpayers may consider the use of such pop-ups too reminiscent of Orwell's *1984*. See Wendy M. Moe, *Should We Wait to Promote?: The Effect of Timing on Response to Pop-Up Promotions* (Apr. 2003), available at <http://interruptions.net/literature/Moe-MS-Submitted.pdf> (drawing inconclusive conclusions on the effectiveness of pop-ups).

67. Jay A. Soled, *Outsourcing Tax Return Preparation and Its Implications*, CPA J., Mar. 2005, at 14-15; see also *Tax Advisor Shortage: US Returns Prepared in India*, Rediff India Abroad, Nov. 24, 2006, <http://www.rediff.com/money/2006/>

taxpayer data overseas raise privacy concerns,⁶⁸ it contributes to the U.S. trade imbalance.⁶⁹ By eliminating the data entry element of tax return preparation, privacy concerns would be minimized and the trade imbalance between the United States and other countries lessened. A related salutary effect of eliminating the menial and costly chore of manual data transferences is that taxpayers who rely on paid tax return preparers would likely experience a fee decrease as tax return preparation work would be a far less labor-intensive enterprise.

B. Third-Party Information Issuers

As explained in Part II, third-party information issuers have a broad array of filing obligations to fulfill lest they be subject to a series of fairly onerous penalties.⁷⁰ As part of their responsibilities, third-party information issuers must undertake a two-step process. Step 1 is that by January 31 of every year, each information provider must distribute paper information statements such as Form W-2s to the taxpayers it employs and Form 1099s to taxpayers who perform independent contractor services or utilize its investment services (e.g., banks).⁷¹ Step 2 is that by mandated dates, third-party information issuers must file this same information with the government.⁷² In order to fulfill this second step, taxpayers typically use what is known as the Filing Information Returns Electronically (FIRE)

2006/nov/24bpo.htm (“[A] report prepared by Pune-based ValueNotes, a leading provider of business intelligence and research . . . ‘says that at least 1.6 million returns will be prepared in India by 2011, but adds that this estimate is quite conservative and the potential is much larger at 22 million returns per year by 2011.’”).

68. See, e.g., Rachel Konrad, *Foreign Accountants Do US Tax Returns*, USA Today, Feb. 23, 2004, http://www.usatoday.com/money/perfi/taxes/2004-02-23-overseas-outsourcing_x.htm (“Although firms have yet to report identity theft or fraud stemming from outsourcing, privacy advocates cringe at the notion of scanning and transmitting W2 forms—along with their Social Security numbers and salary information—across a dozen or so time zones.”).

69. See, e.g., Peter S. Goodman, *Despite Signs of Recovery, Chronic Joblessness Rises*, N.Y. Times, Feb. 21, 2010, at A1 (“Factory work and even white-collar jobs have moved in recent years to low-cost countries in Asia and Latin America.”).

70. See *supra* Part II.B.

71. See *supra* note 27 and accompanying text.

72. See *supra* notes 28–29 and accompanying text.

System.⁷³ The FIRE System is the electronic repository/database of all information return submissions.⁷⁴

Adoption of the proposed electronic submission process would eliminate this two-step process and coalesce it into one step. By the end of every January, using the FIRE System, third-party information issuers would have to submit the relevant information electronically to the IRS.⁷⁵ It would then be the IRS's responsibility to transfer the submitted data onto its website, directing and separating such data in a fashion that enables taxpayers using specialized PINs to have immediate access to this data. In an ideal world, this direction and separation process would take fourteen days or less, enabling taxpayers' access to this critical information by February 15.

From the perspective of third-party information issuers, the cost savings associated with the adoption of this proposal would be enormous. For example, no longer would these third parties endure burdensome postage, paper, and toner costs. In those cases in which these third-party information issuers employed the services of another party to produce these tax information statements, the fees associated with the production of these statements would likely drop dramatically. Finally, if these third-party information providers committed errors in producing these tax information statements, they could quickly and efficiently remedy these errors electronically rather than having to issue new paper statements.

C. Tax Return Preparers

Adoption of this proposal would probably enjoy popularity with seasoned tax accountants. In general, few tax accountants relish the menial chore of manual data entry. Instead, anecdotal evidence suggests that most seasoned tax accountants would prefer to focus their energies and mental acumen on the intellectual task of rendering exceptional tax advice. The

73. See Rev. Proc. 2009-30, 2009-27 I.R.B. 27 (sets forth in elaborate detail how participating taxpayers should electronically submit information to the FIRE System).

74. *Id.*

75. Under current law, the Code requires magnetic-tape filing only if an employer or other payer is submitting at least 250 information returns. IRC § 6011(e)(2)(A). That being the case, instituting this electronic mandate will carry with it an additional burden upon those taxpayers who still submit paper information returns. See U.S. Dep't Treasury, Report to Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite 39, n.46 (2003) (pointing out that in 2000, approximately 3% of information returns submitted to the IRS were on paper). After December 31, 2008, the Treasury Department has discontinued the use of magnetic tapes, supplanted entirely by the use of electronic submissions. See IRS Data Book, *supra* note 5, tbl.14, n.2.

congressional institution of this data aggregation proposal would provide this opportunity. (Needless to say, ordinary tax return preparers who generate a large proportion of their fees via information return data entry might be far less thrilled about congressional adoption of this proposal.)

Depending upon the nature of their businesses, some tax accounting practices may experience enhanced profitability due to adoption of this proposal. More specifically, were Congress to adopt this proposal, many tax accounting firms would be far less inclined to outsource their tax work overseas.⁷⁶ As a practical matter, by keeping all of the tax work under their roofs, these accounting firms would hopefully experience a corresponding increase in their profits.

One other item to keep in mind is that menial data entry is an area ripe for mistakes. While making monotonous data entries, tax return preparers are prone to strike incorrect keys, transpose numbers, and inadvertently omit entries, resulting in the production of flawed tax returns.⁷⁷ Upon discovery, accounting firms that commit such mistakes can fix them, presumably at their own expense, advising their clients to file amended returns.⁷⁸ Other times, when these mistakes are discovered upon audit, accounting firms risk malpractice suits and the subsequent payment of damages.⁷⁹ While the adoption of the data aggregation proposal would not guarantee the production of flawless tax returns, it would certainly lessen the opportunities for mistakes. By lessening the prospects for mistakes, tax preparation and accounting firms might experience fewer costs in the form of fewer labor hours spent amending returns and possibly a concomitant reduction in their malpractice premiums as a result of fewer claims being made.

76. See *supra* note 67 and accompanying text.

77. See IRS Data Book, *supra* note 5, at 38 tbl.15 (delineating the numerous number of math errors that individual taxpayers commit on their tax returns).

78. See Regs. §§ 1.451-1(a), 1.461-1(a)(3) (stating that upon error or omission discovery involving an understatement of income or an overstatement of deductions, a taxpayer “should” file an amended tax return and pay any tax due); Circular 230 instructs tax practitioners who know of an error or an omission on a client’s tax return to promptly notify the client and advise the client of the consequences that such an error or omission engenders under both the Code and regulations. 31 C.F.R. § 10.21 (2002). The AICPA’s Statement on Tax Services No. 6 sets forth a very similar directive applicable to certified public accountants. AICPA, Statement on Tax Services No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings (2010).

79. See Jay A. Soled & Leonard Goodman, Tax Return Preparation Mistakes: How to Avoid or Mitigate Professional Liability, *J. Acct.*, June 2010, at 62.

D. Government

Aside from taxpayers, the single biggest benefactor of this proposal's adoption would likely be the government. The administrative ease that this proposal engenders could bolster tax compliance, thereby boosting the collection of tax revenue.⁸⁰

By way of background, most taxpayers generally have very few direct interactions with the federal government. Tax preparation is one of the few exceptions to this rule because there is a direct interface between the federal government and taxpayers. If tax return preparation generates a perception that the government is inefficient, it produces an image of governmental incompetence, breeding contempt. Conversely, if the tax return preparation process generates a perception that the government is efficient, it produces an image of competency, generating respect. Tax return preparation is thus a pivotal opportunity for the government to put forward its best face, galvanizing support for its political efforts, fostering civic pride in its abilities, and bolstering camaraderie among its citizens.⁸¹

By instituting the data aggregation proposal, Congress would be taking a meaningful step to promote the notion that the nation's tax system operates efficiently. Taxpayers who experience this efficiency would likely tend to be more compliant, fearful that the "efficient" IRS could detect their derelictions. A serendipitous benefit associated with the enhancement of taxpayer compliance is that more revenue will likely flow into the government's coffers. Why? The reason is simple: noncompliant taxpayers rarely overpay their tax obligations; to the contrary, they usually underpay.⁸² If, therefore, the data aggregation could increase taxpayer compliance by a significant percentage, the government could anticipate the flow of a lot more revenue into its coffers.

Another feature of data aggregation is that the IRS staff previously dedicated to transforming paper tax returns into electronic entries would

80. But see *infra* the second-to-last paragraph in Part V, casting some doubt about whether compliance would actually be enhanced.

81. See Lawrence Zelenak, Justice Holmes, Ralph Kramden, and the Civic Virtues of a Tax Return Filing Requirement, 61 *Tax L. Rev.* 53 (2007) (expounding the civic virtues associated with the process of taxpayers fulfilling their obligations under the Code and submitting their tax returns to the government).

82. See, e.g., Stephen J. Dubner & Steven D. Levitt, Filling in the Tax Gap, *N.Y. Times Mag.*, Apr. 2, 2006, at 26 (as part of the National Research Project, the IRS conducted a three-year study and found that the difference between taxes owed and taxes paid represented approximately one-fifth of all taxes collected by the IRS).

have to make far fewer manual tax data entries,⁸³ liberating staff members to conduct more in-depth taxpayer audits. Were the audit rate to increase, taxpayer compliance would likely increase as well.⁸⁴ Consider, too, that most IRS audits are so-called “correspondence audits” currently conducted through what is known as the Automated Underreporter Program, a program that detects flawed tax returns in which taxpayers either inadvertently omitted tax data or erred in reporting such data.⁸⁵ Because electronic data propagation of tax returns could eliminate the vast majority of these mistakes and omissions,⁸⁶ the IRS could save billions of dollars in administrative costs as the number of correspondence audits it conducts would significantly dwindle.

All of this is not to say that the government would not confront challenges in implementing the data aggregation proposal. In particular, the IRS has made clear that the processing and correction of information returns is not as simple as it might initially appear:⁸⁷ it “begins with the receipt and input of information documents, includes several different error checks, and

83. See U.S. Gen. Accounting Office, GAO-02-205, *Tax Administration: Electronic Filing’s Past and Future Impact on Processing Costs Dependent on Several Factors* 4 (2002), available at <http://www.gao.gov/new.items/d02205.pdf>:

In response to a question raised by the House Appropriations Committee in 2001, IRS estimated that 50 million individual income tax returns would be filed electronically in fiscal year 2002. IRS estimated that it would need 3,150 more full-time equivalent staff years if none of those returns were filed electronically. At IRS’ estimate of \$36,300 per staff year, that would be a cost avoidance of \$114.3 million.

84. See Charles O. Rossotti, *Modernizing America’s Tax Agency*, 83 *Tax Notes* 1191, 1195 (1999) (“Historically, the IRS placed great emphasis on direct enforcement revenue, in part because it is precisely measurable and in part because it showed an indirect deterrent effect that increases compliance.”).

85. See, e.g., Gerard H. Schreiber, Jr., *The IRS Underreporter Initiative*, 40 *Tax Adviser* 49 (2009) (“The automated underreporter program, which affects 4–5 million taxpayers annually, starts with third-party information returns filed with the IRS by employers, banks, and brokers. The Service matches the amounts reported on the individual and the information returns and creates an inventory of the resulting mismatches.”).

86. See, e.g., Joint Econ. Comm., *Free E-Filing Makes Sense for Both Taxpayers and the IRS* 1 (2008) (“The IRS finds roughly 1 error in every 100 returns filed electronically (regardless of whether the return was prepared professionally or self-prepared by the taxpayer), compared to about 1 error in every 5 paper returns.”); Arik Hesseldahl, *Is E-File Efficient?*, *Forbes.com*, Mar. 12, 2002, <http://www.forbes.com/2002/03/12/0312efile.html> (error rates with e-filers are much lower compared to taxpayers who file paper returns (1% vs. 18%)).

87. U.S. Dep’t Treasury, *Internal Revenue Serv., Current Feasibility of a Return-Free Tax System* 10–16 (1987).

ends with the correction of any errors detected.”⁸⁸ Were this proposal instituted, the IRS would either have to conduct this process over a much-abridged time period or, rather than delay the process, accept all information returns, whether erroneous or not.

Notwithstanding these challenges, the benefits that this analysis enumerates with the availability of data aggregation extend not only to the federal government but also to every state government that has instituted an income tax.⁸⁹ Virtually every state government that has instituted an income tax system has generally experienced less-than-stellar tax compliance.⁹⁰ Congressional adoption of the data aggregation proposal could thus do double duty: in availing themselves of electronic tax data in order to complete their federal tax returns, taxpayers could do the same in completing their state income tax returns. In other words, all the administrative benefits associated with the adoption of this proposal that inure to taxpayers, third-party issuers, tax return preparers, and the government at the federal level would similarly inure at the state level.

In an effort at full disclosure, adoption of this proposal would no doubt engender additional up-front costs on the government’s part. Either the IRS or Treasury Department would have to develop sophisticated software to process the data it electronically receives, manipulate it into separate accounts, and then make it available to individual taxpayers to download. In the past, when the government has attempted to modernize its computer systems, such efforts have been plagued with problems.⁹¹ The adoption of

88. Robert A. Boisture, Albert G. Lauber & Holly O. Paz, Policy Analysis of “Return-Free” Tax System 16 (2006), available at <http://www.ccianet.org/CCIA/files/ccLibraryFiles/Filename/000000000087/Return-Free%20WP.pdf>.

89. Only seven states do not have an income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Mary Beth Franklin, Tax-Friendly Places to Retire, *Kiplinger’s Personal Finance*, Oct. 1, 2009, at 56. For an interesting perspective of why those states that do not have an income tax or sales tax should have both taxes, see Herwig Schlunk, *Why Every State Should Have an Income Tax (and a Retail Sales Tax, Too)*, 78 *Miss. L.J.* 637 (2009).

90. For example, a report issued by the California Franchise Board estimated the board’s annual tax gap to be approximately \$6.5 billion annually. Franchise Tax Board, *Tax Gap Plan: A Strategic Approach to Reducing California’s Tax Gap 4* (2006), available at <http://www.ftb.ca.gov/aboutFTB/TaxGapStratPlan.pdf>.

91. IRS Oversight Board, *Annual Report to Congress 2008*, at 4 (2009) (imploping the IRS to update its information technology to keep pace with existing technology trends); Michael Phillips, *Additional Actions Are Needed to Effectively Address the Tax Gap 2* (2008), available at <http://treasury.gov/tigta/auditreports/2008reports/200830094fr.pdf> (the fiscal year 2009 budget decreased IRS funding for modernization and improving technology); Memorandum from the Treasury Inspector Gen. for Tax Admin. to Sec’y Paulson, *Management and Performance*

this proposal would leave very little room for error: the last thing the government would want is a website that crashes, thereby risking the loss of critical data and taxpayers' access to it.⁹² That being the case, the government must develop a website that can handle a tremendous amount of taxpayer volume and have a backup plan in place in case of catastrophic failure. Another item that the government must consider is that, at least at inception, it must undertake a significant taxpayer and tax return preparer education campaign,⁹³ inculcating exactly how the availability of electronic tax data information would operate.

Finally, from a legislative perspective, adoption of this proposal would not necessitate a congressional overhaul of the existing penalty structure. Third-party information issuers would still have to complete their submissions in a timely fashion lest they be subject to late penalties,⁹⁴ and such information would still have to be correct lest they be subject to accuracy-related penalties.⁹⁵ In other words, in instituting this electronic data aggregation proposal, Congress could focus its attention primarily upon detailing the IRS's augmented responsibilities and funding the agency to enable it to meet this administrative challenge; left undisturbed would be the basic responsibilities of taxpayers, tax return preparers, and third-party information issuers.

Aside from its administrative benefits and cost savings, adoption of this data aggregation proposal is politically viable. Notwithstanding party affiliation, all members of Congress should find this proposal politically attractive for several reasons. First, there is nothing in this proposal that suggests a tax increase, generally anathema in today's political climate. Second, a proposal such as this can be readily framed as a tax-simplification measure that will save taxpayers money, resources, and time. Third, tax preparation software companies such as Intuit, which, in the past, have sought to obstruct tax- simplification efforts fearing that such efforts might

Challenges Facing the Internal Revenue Service for Fiscal Year 2009, at 1 (Oct. 15, 2008), available at http://www.treas.gov/tigta/management/management_fy2009.pdf (identifying the IRS modernization program, security, and tax compliance initiatives as the IRS's top three challenges).

92. See, e.g., IRS Oversight Board, *supra* note 91, at 20 ("The IRS Business Systems Modernization (BSM) program has been designated by the GAO as an area of high risk since 1995. The GAO made this determination because it believed that the IRS relied on obsolete automated systems for key operational and financial management functions.").

93. See, e.g., Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 *Loy. U. Chi. L.J.* 483 (2009) (explaining the positive correlation between tax education and enhanced tax compliance).

94. See *supra* note 35 and accompanying text.

95. See *supra* notes 35–36 and accompanying text.

subvert their business opportunities,⁹⁶ will likely find this proposal attractive insofar as it will probably increase their client base because more taxpayers will likely prepare their own individual income tax returns.

Another reason that this data aggregation proposal should enjoy political popularity is that its implementation can be instituted in a gradual fashion. More specifically, this proposal does not have to be foisted upon taxpayers on a take-it-or-leave-it basis. To the contrary, taxpayers could “elect” to use the availability of this information on the web. More specifically, during a transition stage,⁹⁷ third-party issuers would continue to issue paper information statements. Taxpayers wishing to have their tax returns propagated electronically could visit the IRS website, download pertinent tax information, and blithely destroy their paper information statements in the shredding machine. Those taxpayers not wishing to “go” electronic could continue to prepare their tax returns the old-fashioned way.

V. RAISING AND ADDRESSING POTENTIAL PROBLEMS ASSOCIATED WITH THE PHASE-OUT OF PAPER INFORMATION STATEMENTS

Like any proposal, the phase-out of paper information statements coupled with the electronic propagation of tax returns engenders potential problems. Nevertheless, these potential problems are just that—potential; and all of them can, in a timely fashion, be addressed and overcome.

Troubling some commentators is the fact that institution of this proposal will greatly facilitate the tax return preparation and filing processes. Yes, you just read the last sentence correctly: there are some commentators who earnestly believe that making the tax administration process too easy camouflages from ordinary taxpayers the burdens associated with the imposition of taxes.⁹⁸ They will therefore attack this proposal’s adoption, fearing that taxpayers who too readily complete their tax returns will be

96. Jim Sanders, Tax-Return Bill Dies in Assembly, *Sacramento Bee*, June 2, 2006, at A4.

97. *Compare* Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. Pa. L. Rev. 47 (1977) (arguing that Congress does not have a duty to provide transition relief to taxpayers who suffer economically as a result of tax reform), *with* Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 Mich. L. Rev. 1129 (1996) (“[E]fficient transition policy [sometimes] entails full transition relief in the form of guaranteed grandfathering. . .”).

98. See, e.g., President’s Advisory Panel on Federal Tax Reform, Transcript of Ninth Meeting 119–21 (May 17, 2005) (testimony of Grover Norquist), available at http://govinfo.library.unt.edu/meetings/docs/transcript_05172005.doc (in arguing against the institution of a return-free system and the administrative ease it would offer, Mr. Norquist made the following assertion: “[T]he present system . . . is at least citizen-based and focuses taxpayers on what they’re paying.”).

ignorant of the tax process just as drivers who pay tolls electronically often are not cognizant of the burdens that the government imposes on them with respect to their driving. The legitimacy of these commentators' complaint is questionable; indeed, there appear far better ways to educate taxpayers about their tax burdens than to subject them to pointless costs and waste their time with unnecessary tasks such as making manual data entries.

Another potential problem with this proposal's adoption is that not all taxpayers have Internet access. If this proposal is to be fully effective, this is a fair criticism and one that Congress will have to address. Even now, however, this argument lacks saliency. Why? Throughout the United States, various studies indicate that the Internet is almost universally available.⁹⁹ In those instances when Internet availability is problematic, the IRS could make the Internet accessible at its walk-in facilities or, alternatively, offer mobile vans—stocked with computers—that could traverse those rural, suburban, and urban areas where, due to technical and socioeconomic reasons, there may be limited Internet access.

Privacy and identity theft are also concerns that cannot be readily dismissed. Indeed, privacy and identity theft issues are endemic Internet problems,¹⁰⁰ and, to date, the IRS has had a lackluster record addressing these issues.¹⁰¹ Nevertheless, over the last few years the government has taken several steps that manifest its ability to prevent taxpayers' private information from falling into the wrong hands.¹⁰² These steps, along with

99. See, e.g., Donna Gordon Blankinship, Study: Third of Americans Use Library Computers, *Boston Globe*, Mar. 25, 2010, www.boston.com/news/nation/nation/articles/2010/03/25/study_third_of_americans_use_library_computers/ (“A third of Americans 14 and older—about 77 million people—use public library computers to look for jobs, connect with friends, do their homework and improve their lives, according to a new study. . . .”); Internet World Stats, United States of America Internet Usage and Broadband Usage Report, <http://www.internetworldstats.com/am/us.htm> (demonstrating that in 2009, 74.1% of the U.S. population was Internet users and showing an upward usage trend in the future).

100. Admittedly, no website system is ever completely impenetrable to security breaches. See, e.g., Malcolm Moore & Nicola Woolcock, Tax Website Suspended After Security Breach, *Daily Telegraph*, May 31, 2002.

101. See Treasury Inspector Gen. for Tax Admin., *supra* note 39, at 3 (“[O]ur review of available test documents provided by the IRS showed that the MeF system was deployed with known security vulnerabilities.”); U.S. Gen. Accounting Office, GAO-01-306, Information Security: IRS Electronic Filing Systems 14 (2001), available at <http://www.gao.gov/new.items/d01306.pdf> (acknowledging that there are “[a] number of serious control weaknesses in IRS’ electronic filing systems”).

102. See Jose E. Serrano, House Appropriations Committee Releases Report for Fiscal 2010 Financial Services Spending Bill, H.R. Rep. No. 111-202, at 26 (2009):

other information safeguards it plans to implement,¹⁰³ indicate that the government is ready to tackle the privacy and identity theft issues associated with this proposal's adoption.

A final potential problem associated with the institution of this proposal is that it may weaken taxpayer compliance. More specifically, after downloading tax data from the IRS website, taxpayers will undoubtedly familiarize themselves with what information the government possesses (and, by default, what information it lacks); as a result of this knowledge, some dishonest taxpayers will be tempted not to report income beyond what the government "knows" about. Of all the potential problems associated with the adoption of this proposal, this one has the most merit and requires congressional vigilance and attention.¹⁰⁴ While this analysis would not

The IRS has taken several important steps to protect taxpayer data. For example, as TIGTA notes, it has established a Security Services and Privacy Executive Steering Committee to serve as the primary governance body for all matters relating to security and privacy issues in the IRS. It has made steady progress each year in complying with the requirements of the Federal Information Security Management Act. In addition, IRS has established an office of Privacy, Information Protection and Data Security to: (1) improve public, preparer and external stakeholder awareness of privacy policies, procedures, and general information, and (2) improve the IRS response to taxpayers and practitioners who fall victim to data loss incidents, identity theft, or online fraud.

See also U.S. Gov't Accountability Office, GAO-10-355, *Information Security: IRS Needs to Continue to Address Significant Weaknesses 5* (2010), available at <http://cryptome.org/gao-10-355.pdf> ("During fiscal year 2009, IRS has made progress toward correcting previously reported information security control weaknesses and information security program deficiencies at its three computing centers, another facility, and enterprisewide.").

103. See H.R. Rep. No. 111-102 (2009); U.S. Gov't Accountability Office, *supra* note 102.

104. This is the virtually identical complaint initially lodged against the ReadyReturn program instituted in California. See Joseph Bankman, *Simple Filing for Average Citizens: The California ReadyReturn*, 107 *Tax Notes* 1431 (2005) (providing a complete overview of how the ReadyReturn program is designed to operate). The ReadyReturn program involved the state of California completing and disseminating state income tax returns to California residents who met certain criteria (e.g., those who did not itemize and had wage income only). Recipients of these returns could ignore them, adjust them, or sign and submit them. Despite the fear that California taxpayers who earned income beyond that which was reflected on the proposed state income tax return would not be forthcoming about the receipt of other income, in the vast majority of cases, the legislature's compliance fears proved unfounded. See California Franchise Tax Board, *ReadyReturn Service—Frequently Asked Questions 3* (2007), available at www.ftb.gov/readyReturn/faq_

anticipate a significant decline in taxpayer compliance, there might be a core of dishonest taxpayers who fail to report income beyond that downloadable from the IRS website. There are, of course, several ways to combat this compliance challenge: expand those occasions upon which information returns are required to be issued,¹⁰⁵ increase the number of audits that the IRS conducts,¹⁰⁶ and/or raise applicable noncompliance penalties.¹⁰⁷ These proposed redresses are not mutually exclusive: Congress can adopt one or more of these tactics at the same time and thereby strengthen taxpayer compliance and rein in taxpayer derelictions.

Every proposal has blemishes, and this proposal does not violate this axiom. However, none of the shortcomings just mentioned are insurmountable. To the contrary, in the vast majority of cases, the potential problems that this analysis raises are fairly easy to remedy. And, since this proposal is designed to be gradually phased in,¹⁰⁸ it allows ample time to address these issues and others that may crop up as electronic propagation becomes the next major advancement in tax return preparation.

VI. CONCLUSION

For a moment, think about the redundancy engendered by the issuance of paper information statements. As required under the Code, by the end of every January, third parties must issue paper information statements to taxpayers and subsequently submit tax information returns to the IRS, the vast majority of the latter of which are in electronic form and contain

about.shtml (“We found that 99.9 percent of the income ReadyReturn participants reported to the IRS was also reported to the FTB. . . . [T]hese findings suggest a minimal negative tax effect due to ReadyReturn (less than \$3 per return.”); California Franchise Tax Board, Report to the Legislature (Apr. 23, 2009), available at <http://www.ftb.ca.gov/readyReturn/ReadyReturnReport2009.pdf> (in this report, there is no mention that taxpayer compliance suffered as a result of this program being instituted).

105. See *supra* note 25.

106. See, e.g., James Alm et al., Deterrence and Beyond: Towards a Kinder, Gentler IRS, in *Why People Pay Taxes*, 311, 322–23 (Joel Slemrod ed., 1992) (“[C]ompliance . . . rises when the audit rate increases.”); Alan H. Plumley, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results* 8–10 (2002) (finding that if the audit rate were 1% higher in 1991, the general population would have voluntarily reported an additional \$56 billion of tax).

107. See Michael Doran, *Tax Penalties and Tax Compliance*, 46 *Harv. J. on Legis.* 111 (2009) (explaining various theories on the relationship between penalty imposition and enhanced tax compliance); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 *Colum. L. Rev.* 569 (2006) (identifying and analyzing similar issues).

108. See *supra* note 97.

identical information sent to taxpayers. In order to e-file their returns,¹⁰⁹ taxpayers must then take the tax data they received in paper form and, like most third-party issuers, transform such data into an electronic format. The duplication of effort by third parties and taxpayers to transform tax data into an electronic format is nonsensical. To any casual observer, the issuance of paper information statements clearly constitutes an unnecessary, duplicative step that Congress should immediately seek to phase out.

Years ago, the state of technology admittedly necessitated the issuance of paper information statements. But the technological age of the Internet has fundamentally transformed the availability of information and its ease of storage, making it much more readily accessible electronically. By tapping into the power of the Internet, the benefits inuring to taxpayers, third-party issuers, tax return preparers, and the government would be enormous. Furthermore, in the case of the government, aside from administrative savings associated with the adoption of this proposal, the government could expect to generate additional tax revenue as the accuracy of taxpayers' returns dramatically increases and the costs associated with the processing of these returns dramatically decreases.

Most proposals that are as revolutionary as this one suffer from one or more significant shortcomings. For example, they are expensive to implement, technologically infeasible, or politically untenable. This proposal shares none of these deficiencies. It stands far apart from other such revolutionary proposals because it entails virtually no palpable weaknesses.

From this analysis, the message that members of Congress and their staff should take away is that the time to act is now. The path to the promised land of enhanced tax compliance is ready to be pioneered. It is a path on which the vast majority of income tax returns can, with the push of a few keys that download the taxpayer's pertinent tax information, be completed in a matter of a few minutes.

109. See IRS News Release IR-2010-35 (Mar. 23, 2010) ("More than 82% of the 69 million returns received this year [(i.e., 2009 tax year)] have come in via e-file."); Shulman Testimony 2010, *supra* note 25, at 3 (referring to the 2009 tax filing season, the Commissioner commented that "e-file as a percentage of total individual returns is up from 80% to 83%—continuing a very positive trend").