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Taxation and Surveillance: An Agenda

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TAXATION AND SURVEILLANCE: AN AGENDA

Michael Hatfield *

17 YALE J.L. & TECH. 319 (2015)

The IRS has always been an information intensive enterprise. But it's the organization of data and ultimately the knowledge and intelligence we extract from the information we receive that really matters. It can show us the areas of greatest non-compliance . . . and thereby, contributes to more efficient and effective compliance programs.

– IRS Commissioner Doug Schulman (2011)¹

Every animate and inanimate object on earth will soon be generating data, including our homes, our cars, and, yes, even our bodies.

– THE HUMAN FACE OF BIG DATA (2012)²

ABSTRACT

Among government agencies, the IRS likely has the surest legal claim to the most information about the most Americans: their hobbies, religious affiliations, reading activities, travel, and medical information are all potentially tax relevant. Privacy scholars have studied the arrival of Big Data, the internet-of-things, and the cooperation of private companies with the government in surveillance, but neither privacy nor tax scholars have considered how these technological advances should impact the U.S. tax system. As government agencies and private companies increasingly pursue what has been described as the “growing gush of data,” the use of these

* Professor of Law, University of Washington School of Law. I would like to thank Neil Buchanan, Andrew Blair-Stanek, Ryan Calo, Michelle Drumbl, Heather Field, Will Foster, Steve Johnson, Gary Lucas, Katie Pratt, Rebecca Morrow, and Scott Schumacher for their insightful feedback. I would like to thank Mary Whisner, Daniel Goodrich, Chamaine Ko, Kerri Russ, Cheryl Nyberg, Anna Endter, Grace Lee, and Jeremy McCabe for their research and editorial assistance. All errors and omissions are my own.

¹ Doug Shulman, Comm’r of the Internal Revenue Serv., Prepared Remarks to the Leaders and Legends Series, Johns Hopkins Carey Business School, Baltimore (May 18, 2011), <http://www.irs.gov/uac/Prepared-Remarks-of-IRS-Commissioner-Doug-Shulman-to-the-Leaders-&-Legends-Series,-Johns-Hopkins-Carey-Business-School,-Baltimore>.

² RICK SMOLAN & JENNIFER ERWITT, THE HUMAN FACE OF BIG DATA (2012).

technologies in tax administration will become increasingly important to consider. This Article provides an agenda of items for discussion, debate, and research related to the development, implementation, and effects of a surveillance-facilitated tax system.

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Introduction

Although the Internal Revenue Service (IRS) “has always been an information intensive agency,”³ its information-gathering has never been the focus of privacy scholars. Those

³ Schulman, *supra* note 1.

scholars have instead focused on agencies such as the National Security Administration (NSA).⁴ But the IRS's legal claim to private information is remarkable. It is entitled to collect information about who sleeps how often in your house,⁵ your hobbies,⁶ your reading preferences,⁷ your religious affiliation,⁸ your travel plans,⁹ your weight and your doctor's recommendations about it,¹⁰ your spouse or your dependent's abortion, sterilization,¹¹ or gender identity disorder,¹² and if

⁴ See, e.g., David Gray & Danielle Citron, *The Right to Quantitative Privacy*, 98 MINN. L. REV. 62 (2013) [hereinafter Gray & Citron, *Quantitative Privacy*]; Danielle Keats Citron & David Gray, *Addressing the Harm of Total Surveillance: A Reply to Professor Neil Richards*, 126 HARV. L. REV. 262 (2013) [hereinafter Citron & Gray, *Total Surveillance*]; Neil M. Richards, *The Dangers of Surveillance*, 126 HARV. L. REV. 1934 (2013).

⁵ This information may be relevant to determining tax consequences of payments to a separated spouse who is living in the house and dependency status in the case of a child. See I.R.C. § 71(b)(1) (West 2014) (defining alimony payments to a separated spouse who is in the same household as not excludable from income); I.R.C. § 152(c)(1)(B) (West 2014) (defining a qualifying child as a dependent residing at the same principal place of abode as the taxpayer for more than one-half of the year); and Treas. Reg. § 1.152-1(b) (1971) (defining the dependent including special circumstances of absences of less than 6 months).

⁶ See Treas. Reg. § 1.183-1 (1972) (listing factors for determining if an activity is a hobby for which losses are not deductible).

⁷ Reading habits may be relevant, for example, to determine whether or not one has undertaken an activity with a motive of making a profit. See, e.g., *Nickerson v. Comm'r*, 700 F.2d 402 (7th Cir. 1983) (stating that facts including a taxpayer's reading about farming were evidence that he pursued that activity with a profit-seeking motive).

⁸ Not only may financial support of religious organizations be tax relevant, but also the distance from a taxpayer's home to any of her religious organizations. See I.R.C. § 170(b)(1) (West 2014) (covering charitable contributions and gifts to a church or convention or association of churches); Treas. Reg. § 1.121-1(b) (2002) (stating that location of religious organization with which taxpayer affiliates is relevant to determining principal residence for gain exclusion).

⁹ For example, was the travel for personal, business, educational, or medical purposes—or some combination? I.R.C. § 213(d)(1)-(d)(2) (West 2014) (stating that transportation and lodging expenses for medical care are deductible); Treas. Reg. § 1.162-2 (1960) (covering travel for business, mixed business, and personal reasons); and Treas. Reg. § 1.162-5(b) (1967) (covering travel as a form of education).

¹⁰ See I.R.S. Priv. Ltr. Rul. 80-04-111 (Oct. 31, 1979) (setting out weight loss program fees as deductible where prescribed by physicians for the alleviation of specific ailments); Rev. Rul. 79-151, 1979-1 C.B. 116 (noting that weight loss program fees are not deductible even though physician-recommended where not prescribed for the alleviation of specific ailment).

¹¹ See Rev. Rul. 73-201, 1973-1 C.B. 140 (deeming legal abortions and vasectomies deductible medical care under I.R.C. § 213).

¹² See, e.g., Rev. Rul. 2003-57, 2003-22 I.R.B. 959 (deeming breast reconstruction following mastectomy to be deductible). *But see* *O'Donnabhain v. Comm'r*, 134 T.C. No. 4 (2010) (finding that hormone therapy and sex reassignment surgery are deductible expenses to treat

you were considering a carnal *quid pro quo* when you made a gift to your “mistress.”¹³ Yet, privacy scholars have taken no note of the IRS’s extraordinary legal claim to such information.

From the reverse angle, despite the information-intensive aspects of tax law, tax scholars have not taken note of the increasing pervasiveness of information technology.¹⁴ Modern technologies are creating “minutely detailed records” of our existence,¹⁵ increasingly facilitating the “persistent, continuous and indiscriminate monitoring of our daily lives.”¹⁶ One information privacy scholar described the radical and technological transformation of personal information:

The small details that were once captured in dim memories or fading scraps of paper are now preserved forever in the digital minds of computers, vast databases with fertile fields of personal data Every day, rivulets of information stream into electronic brains to be sifted, sorted, rearranged, and combined in hundreds of different ways. Technology enables the preservation of the minutia of our everyday comings and goings, of our likes and dislikes, of who we are and what we are It is ever more possible to create an electronic collage that covers much of a person’s life—a life captured in records, a digital biography composed in the collective computer networks of the world.¹⁷

A prominent national security advisor has predicted that by 2040, all of our daily activities will be known by “governmental

“gender identity disorder” disease, but that breast augmentation was merely cosmetic and not a deductible expense).

¹³ Transfers to a sexual partner may be characterized as either non-taxable gifts or as taxable compensation for sexual activity. *See, e.g.*, *United States v. Harris*, 942 F.2d 1125, 1131-1135 (7th Cir. 1991) (reviewing the “current law on the tax treatment of payments to mistresses”).

¹⁴ Tax scholars have not considered the relevance to tax administration of the Big Data revolution, the rise of the internet-of-things, or other aspects of the information technology revolution. While some scholars have addressed “tax privacy,” their primary focus is determining the conditions for IRS disclosure of individual income tax return information. *See, e.g.*, Joshua D. Blank, *In Defense of Individual Tax Privacy*, 61 EMORY L. J. 265 (2011); Marjorie E. Kornhauser, *Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?* 18 CAN. J.L. & JURIS. 1 (2005); Marc Linder, *Tax Glasnost for Millionaires: Peeking Behind the Veil of Ignorance Along the Publicity-Privacy Continuum*, 18 N.Y.U. REV. L. & SOC. CHANGE 951 (1990); and Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 U. KAN. L. REV. 1065 (2002).

¹⁵ Richards, *supra* note 4, at 1934.

¹⁶ Citron & Gray, *Total Surveillance*, *supra* note 4 at 274.

¹⁷ Daniel J. Solove, *Privacy and Power: Computer Databases and Metaphors for Information Privacy*, 53 STAN. L. REV. 1393, 1394 (2001).

and corporate entities” pursuing the “growing gush of data” from the “internet of things.”¹⁸ As we move towards such a future, the IRS most likely will be among those entities pursuing this growing gush of data. This Article suggests an agenda for discussion among privacy and tax law scholars: issues we ought to consider, research we ought to pursue, and debates we ought to have.

In Part I of this Article, I describe the flow of tax-relevant information from taxpayers and third parties to the IRS. I point out two significant problems in that information flow: the compliance burden and the compliance gap. In Part II, I predict that, over the next twenty-five years, surveillance technologies will be used to reduce the compliance burden and gap. I consider the technological and political factors that may pave or block the way for such an increase in surveillance to improve tax administration. In Part III, I recommend a research agenda in an effort to make the integration of surveillance into tax administration more beneficial than harmful. Ultimately, reforming tax law to fit the emerging technology and our privacy expectations will be essential to integrating the information technology revolution into tax administration without disrupting the administration itself.

I. The Tax Information Flow and Gap

In this Part, I describe the information needed to prepare and file an individual’s income tax return. The IRS is legally entitled to a great deal of information from a taxpayer. But in practice, very little information is turned over, mostly due to the extremely low audit rate of less than one percent.¹⁹ The tax-return-preparation burden on individuals is quite substantial, amounting to about 7.6 billion work hours a year.²⁰ And about \$450 billion of tax revenue is lost each year due to taxpayers’ failure to comply with the tax law.²¹ Both of these problems are ameliorated when third parties provide tax-relevant information to both the taxpayers and the IRS. Thus, third-party reporting of information has become essential to the administration of the individual income tax. In Section A, I describe the current system of providing individual income tax information to the IRS.²² In Section B, I highlight problems

¹⁸ Richard Clarke, *Richard Clarke on the Future of Privacy: Only the Rich Will Have It*, WALL ST. J., July 7, 2014, <http://online.wsj.com/articles/richard-clarke-on-the-future-of-privacy-only-the-rich-will-have-it-1404762349>.

¹⁹ See *infra* note 29.

²⁰ See *infra* notes 80-81.

²¹ See *infra* note 100.

²² I am concerned only with the individual income tax, which is the single largest source of revenue for collection and returns for processing by the

that reflect the information gap between the taxpayer and the IRS and that lead to a great loss of tax revenue.

A. *How the IRS Acquires Taxpayer Information*

On one hand, the IRS is entitled to any information that may be relevant to determining any tax liability,²³ so it has tremendously broad legal authority to demand information. On the other hand, for a variety of reasons, especially the very low audit rate, relatively little information beyond the numbers on the face of the tax return is ever provided. The following describes the current system of providing individual tax information to the IRS.

1. Information Provided by the Taxpayer

To understand how information is provided to the IRS, it is important to understand the individual income tax return preparation and filing process. After the close of each year, any individual with gross annual income exceeding a certain amount must file an income tax return.²⁴ About 145 million individual income tax returns are filed annually.²⁵ The taxpayer is responsible for learning the relevant law, gathering the relevant factual information, and applying the law to the facts as necessary to determine and report his or her liability for the year. This can be very complicated. For example, a taxpayer who pays for work on the roof of a business warehouse must navigate detailed treasury regulations to determine whether the expense should be deducted or capitalized.²⁶ The return does not require disclosure of the legal

IRS, and, as a tax on individuals, raises the most complex privacy issues. See *The Agency, Its Mission and Statutory Authority*, INTERNAL REVENUE SERV., <http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority> (last visited Apr. 13, 2015) (stating that the IRS collected over \$2.5 trillion and processed over 237 million returns in 2012).

²³ I.R.C. § 7602 (West 2014) (defining the examination of books and records); *Id.* § 7801 (defining the authority of Treasury Department); *Id.* § 7803 (outlining the duties and authority of the IRS Commissioner).

²⁴ *Id.* § 6012 (defining persons required to make returns of income). An individual with gross income not exceeding the sum of the exemption and standard deduction need not file a return. *Id.* § 6012(a). For 2014, this threshold amount was \$10,500 for a single individual. INTERNAL REVENUE SERV., 1040 INSTRUCTIONS 2013, at 7 ch. A, <http://www.irs.gov/pub/irs-prior/i1040--2013.pdf>.

²⁵ INTERNAL REVENUE SERV., SOI TAX STATS—INDIVIDUAL INCOME TAX RETURNS PUBLICATION 1304 tbl.1.1, 2012, [http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns-Publication-1304-\(Complete-Report\)](http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns-Publication-1304-(Complete-Report)) (last updated Aug. 22, 2014). [*hereinafter*, IRS, *SOI Tax Stats*]. This number includes returns filed by both single taxpayers and married taxpayers.

²⁶ This requires determining if the work should be characterized as a repair, betterment, restoration, or adaptation. See Treas. Reg. § 1.162-4(a) (2014) (deeming the cost of repairs deductible in most cases); Treas. Reg.

analysis behind a taxpayer's characterization (e.g., that the expense is deductible), nor does it require the taxpayer to supplement the return with the underlying supporting information (e.g., receipts).²⁷ For the most part, the return only requires numbers the taxpayer has concluded to be the legally correct ones (e.g., the amount deductible). Once the return is filed, it is subject to an automated review which checks for mathematical errors and compares the information on the return with information the IRS has obtained elsewhere.²⁸ Less than one percent of individual tax returns are ever audited.²⁹

In the rare case that a taxpayer is audited, the IRS may demand that the taxpayer provide more information than provided with the return. The taxpayer is obligated to maintain the records necessary to substantiate what he or she determined to be the tax liability,³⁰ and the IRS is entitled to examine "any books, papers, records, or other data which may be relevant" to determining any tax liability.³¹ As part of its audit, the IRS may penalize the taxpayer for failing to

§ 1.236(a)-3(d) (2013) (defining betterments, restorations, and adaptations of property as capitalized rather than deducted); Treas. Reg. § 1.263(a)-3(j), Ex. 13 (2014) (using the example of roof betterment); Treas. Reg. § 1.263(a)-3(k), Ex. 14 (2014) (using the example of roof restoration).

²⁷ When assembling his or her Form 1040, a taxpayer is to submit only items specifically required. The Form 1040 does not require the taxpayer to submit his or her legal reasoning in support of any deductions, nor does it require submission of receipts associated with deducted expenses. *See* 1040 INSTRUCTIONS 2013, *supra* note 26 at 72 (instructing taxpayers to submit only the materials required).

²⁸ *See* Caroline Rule, *BNA Tax Management Portfolio 623-3rd: IRS Procedures: Examinations and Appeals*, Section IB (2013) (describing the mostly automated review of all tax returns).

²⁹ In 2012, 99.1% of individual tax returns were not audited. While audit rates went up with income, a full 70% of returns reporting over ten million in income were not audited. INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK 2012, tbl. 1 (Steven T. Miller et al. eds., 2012). The IRS aims to audit only those returns it determines likely to have errors. *See* Rule, *supra* note 30, Section IIA (describing how returns are selected for further examination).

³⁰ With respect to this tax-relevant information, Congress has granted the Treasury broad authority to prescribe the taxpayer's obligations to provide the information. I.R.C. § 6001 (West 2014). The Secretary is entitled to require any person to "make such returns, render such statements, or keep such records as the Secretary deems sufficient to show whether or not such person" has an income tax liability, and every person who does have an income tax liability must "keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary" prescribes. Treas. Reg. § 1.6001-1(a) (1990); *see also* MARTIN J. MCMAHON & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 39.01[8] (Thomson Reuters ed., 2013).

³¹ I.R.C. § 7602 (West 2014) (defining the examination of books and records); *Id.* § 7801 (defining the authority of Treasury Department); *Id.* § 7803 (outlining the duties and authority of the IRS Commissioner).

maintain the adequate records³² or for failing to have a suitably strong legal argument for the disputed characterization (e.g., the claim that an expense is deductible).³³ If the taxpayer and IRS are unable to resolve their differences during the audit, the dispute may then be litigated in court.

In preparing his or her return, the taxpayer bears the burden of interpreting the law, gathering the factual information, and applying the law to it. The relevance of information is laid out in multiple sources and in varying levels of detail. The Internal Revenue Code, Treasury Regulations, administrative rulings and publications, and court cases all determine what information is relevant under a given provision.³⁴ Determining the individual's taxable income requires all information necessary to determine if a receipt or benefit is includible in or excludible from income, whether or not an expense is deductible from income, and which credits, if any, reduce the tentative tax liability.³⁵ Some of the information required for determining taxable income is simple, such as the amount of a taxpayer's paycheck.³⁶ Other

³² *See, e.g., id.* § 7203 (deeming failure to keep required records to be a misdemeanor).

³³ For example, the taxpayer is subject to a penalty for a substantial understatement of income tax, I.R.C. § 6662(b)(2) (West 2014), except to the extent that the underlying position had substantial authority or was disclosed with the return and had a reasonable basis, *id.* § 6662(d)(2)(B).

³⁴ For example, I.R.C. § 213 provides specific definitions that must be satisfied for medical expenses to be deductible. The Treasury Regulations require submission of whatever information "the district director may deem necessary" to determine the deductibility of a medical expense. Treas. Reg. § 1.213-1(f) (1979) (outlining substantiation requirements, including "the nature of any other item of expense and for whom incurred and for what specific purpose, the amount paid therefor and the date of the payment thereof"). The relevant information is then discussed on four of the more than two hundred pages of instructions for the 1040. *See* 1040 INSTRUCTIONS 2013, *supra* note 24, at 5, A-1, A-2, and A-3 (discussing medical expenses). Relevant information is also covered in more detail in a special thirty-five page publication. INTERNAL REVENUE SERV., PUBLICATION 502: MEDICAL AND DENTAL EXPENSES: FOR USE IN PREPARING 2014 RETURNS (2014). For some specific expenses, additional administrative rulings have been issued regarding relevant information. *See, e.g.,* Rev. Rul. 79-151, 1979-1 C.B. 116 (establishing that weight loss program fees are not deductible even if recommended by a physician). Similarly, the courts have addressed what is relevant. *See O'Donnabhain v. Comm'r*, 134 T.C. No. 4 (2010) (holding that the treatment of "gender identity disorder" disease, hormone therapy and sex reassignment surgery were deductible expenses, but that breast augmentation was merely cosmetic and not a deductible expense).

³⁵ *See* I.R.C. § 61 (West 2014) (defining gross income); *id.* § 63 (defining taxable income); *id.* §§ 51-53 (defining credits against tax); *id.* §§ 101-140 (defining exclusions from income); *id.* §§ 161-210 (defining deductions against income).

³⁶ *Id.* § 61 (stating that gross income includes compensation for services).

information required is complex, such as the taxpayer's reason for taking a trip³⁷ or making a gift.³⁸ Some information is strictly necessary, such as the purchase price of an asset.³⁹ Other information is necessary only for administrative safe harbors, such as those for excluding gain on the sale of a residence⁴⁰ or characterizing an investment as active rather than passive.⁴¹ Some of the information is relatively public, such as one's address. Other information is intensely private, such as information related to the medical care of oneself or one's family members.⁴²

While a tremendous amount of information may be relevant and may be subject to review by the IRS in the event of an audit, audits are exceedingly rare. In almost all cases the only information that the taxpayer provides to the IRS is what is provided on the face of the return and as a supplement to it (such as the Form W2 from the taxpayer's employer). More information is only provided if the IRS requests it. Thus, much of the relevant information never flows into the IRS. For example, though the information recording requirements for charitable contributions are fairly detailed,⁴³ none of those records are submitted with the return.⁴⁴ The taxpayer claiming the charitable contribution deduction is obligated to maintain records and provide them to the IRS if requested.

But it is not only the low audit rate that reduces the amount of tax-relevant information actually provided to the IRS for review. In order to lessen the burden on the taxpayer

³⁷ Whether a trip is primarily for business or personal purposes determines the deductibility of travel expenses under I.R.C. § 162. *See* Treas. Reg. § 1.162-2(a) (1960) (establishing that whether one undertakes trips for purposes other than business or solely for business purposes affects whether the expenses for said trip are tax deductible).

³⁸ To be excluded from income under I.R.C. § 102 (excluding gifts inter alia), the transferor's motive must be one of detached and disinterested generosity. *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

³⁹ I.R.C. § 1012 (West 2014) (defining the cost basis of property).

⁴⁰ *See, e.g.*, Treas. Reg. § 1.121-3 (2004) (outlining safe harbors for reduced maximum exclusions for taxpayers who fail to meet certain requirements).

⁴¹ *See, e.g.*, Treas. Reg. § 1.469-5T(a)(1) (1996) (setting the threshold for temporary material participation at more than five hundred hours spent on an activity in a year).

⁴² *See* I.R.C. § 213 (West 2014); *see also, e.g., id.* § 213(d)(3) (listing prescribed drugs as deductible medical expenses); I.R.S. Priv. Ltr. Rul. 80-04-111 (Oct. 31, 1979) (deeming weight loss program fees deductible where prescribed by physicians for alleviation of specific ailments); Rev. Rul. 79-151, 1979-1 C.B. 116 (stating that weight loss program fees are not deductible even though physician-recommended if not prescribed for alleviation of specific ailment); and Rev. Rul. 55-261, 1955-1 C.B. 307 (stating that health club fees may be deductible if prescribed for alleviation of specific ailment).

⁴³ *See* Treas. Reg. § 1.170A-13 (1996).

⁴⁴ 2013 1040 INSTRUCTIONS, *supra* note 24, at A-9.

and to simplify tax administration, Congress has reduced the amount of tax-relevant information for many taxpayers. Congress has done this through the standard deduction mechanism. More than two-thirds of individual taxpayers choose the single (and simple) standard deduction in lieu of multiple (and complex) itemized deductions.⁴⁵ While there is a great deal of information relevant to claiming itemized deductions, much less information is required for those taxpayers electing the standard deduction. However, while the standard deduction reduces a taxpayer's information burden, it does not eliminate it.⁴⁶ Information is still required to determine the taxpayer's filing status,⁴⁷ qualifying dependents,⁴⁸ inclusions⁴⁹ and exclusions⁵⁰ from the taxpayer's income, available credits,⁵¹ and a fair number of deductions not precluded by the standard deduction, such as for business expenses,⁵² alimony payments,⁵³ moving expenses,⁵⁴ and education expenses.⁵⁵

Arguably, a taxpayer who does not want to subject certain information to IRS review could simply forego the related deduction or credit. For example, a taxpayer who does not want the IRS to have the right to review the details of his or her charitable support simply might choose not to claim the

⁴⁵ For the most recent year reported, 2012, sixty-seven percent of individual income tax returns reported the standard rather than itemized deductions. IRS, *SOI Tax Stats*, *supra* note 25, tbl 1.2

⁴⁶ When taking the standard deduction, the taxpayer is precluded from taking itemized deductions. I.R.C. § 63(b) (West 2014) (defining taxable income for individuals who do not itemize deductions); *see also* MCMAHON AND ZELENAK, *supra* note 30, ¶ 21.04. Itemized deductions are all deductions, other than the above-the-line deduction in I.R.C. § 62(a) and the personal exemption deduction in I.R.C. § 151. *See* I.R.C. § 63(d) (West 2014).

⁴⁷ *See* I.R.C. § 1 (West 2014) (setting forth different tax tables based on the taxpayer's filing status).

⁴⁸ *See Id.* § 152 (defining qualifying child or relative).

⁴⁹ *Id.* §§ 71, 74, 83 (describing alimony and separate maintenance, prizes and awards, and property transferred in connection with performance of services, respectively).

⁵⁰ *Id.* §§ 102, 121, 132 (describing gifts and inheritances, exclusion of gain from sale of principal residence, and certain fringe benefits, respectively).

⁵¹ *Id.* §§ 32, 36 (describing earned income and first-time home buyer credit).

⁵² *Id.* § 62(a)(1) (defining trade and business deductions to be used in computing adjusted gross income).

⁵³ *Id.* § 62(a)(10) (listing deduction for alimony as provided in I.R.C. § 215 in computed adjusted gross income).

⁵⁴ *Id.* § 62(a)(15) (listing moving expense deduction in computing adjusted gross income as provided in I.R.C. § 217).

⁵⁵ *Id.* § 62(a)(17)-(18) (listing educational loan interest deduction as provided in I.R.C. §§ 221 and educational expense deductions as provided in I.R.C. § 222 in computing adjusted gross income).

charitable contribution deduction.⁵⁶ However, this is not as simple as it may seem at first. Some lawyers argue that no part of the statutory formula for determining tax liability is optional. They emphasize that the formula is arithmetic: exclusions are excluded, inclusions are included, deductions are deducted, and credits are credited.⁵⁷ But, theories aside, in fact, taxpayers often forego deductions for which they qualify. Sometimes they do so for strategic reasons, such as limiting their (perceived) audit risk or reserving some deductions to claim in settlement negotiations of multiple issues if the return is audited.⁵⁸ Sometimes they do so in an effort to keep certain information from being subject to IRS review.⁵⁹ Perhaps most of all, however, they do so out of ignorance of the deductions available to them.

Another complication in IRS information collection is that otherwise relevant information available for IRS review may become irrelevant as a result of computational mechanics. For example, in the case of the “miscellaneous itemized deductions,” none of the deductions can be taken unless all of the deductions together exceed a percentage of the taxpayer’s adjusted gross income.⁶⁰ Similarly, taxpayers with income exceeding certain amounts may not be entitled to claim certain deductions or credits, such as the deduction on qualified education loans⁶¹ or the Hope Scholarship Credit.⁶² Taxpayers who otherwise would qualify for deductions or credits will have the relevant information become irrelevant if they fail to qualify due to excessive income. Some deductions are available for only substantial expenditures, such as the medical expense

⁵⁶ See James Edward Maule, *No Thanks Uncle Sam, You Can Keep Your Tax Break*, 31 SETON HALL LEGIS. J. 81, 91 (2006).

⁵⁷ *Id.* at 83-84 (characterizing the debate over the obligatory nature of deductions as one of the deepest, most intense, and longest-lasting on the e-mail list-serve of the American Bar Association Section on Taxation).

⁵⁸ *Id.* at 89-92.

⁵⁹ See, e.g., *id.* at 141 (citing *Beatty v. Commissioner*, 40 T.C.M. (CCH) 438 (1980), in which the “taxpayer stated ‘that if verification was required of him then he was willing to forego the deduction as the price for preventing the government from interfering in his private affairs.’”)

⁶⁰ These are the miscellaneous itemized deductions, which I.R.C. § 67 provides may not be taken except to the extent that their sum total exceeds two percent of the taxpayer’s adjusted gross income. Examples of miscellaneous itemized deductions include I.R.C. §§ 163 (Interest), 164 (Taxes), 165 (covering casualty and theft losses), 170 (Charitable, etc., contributions and gifts), and 213 (Medical, dental, etc., expenses).

⁶¹ I.R.C. § 221(b)(2)(B) (West 2014) (reducing the deduction amount for taxpayers with adjusted gross income over \$65,000 and eliminating it entirely for adjusted gross incomes above \$80,000).

⁶² *Id.* § 25A(d)(2)(A) (reducing the amount of the Hope Scholarship Credit to “the excess of the taxpayer’s modified adjusted gross income for such taxable year over \$40,000 for tax years prior to 2014 and \$80,000 for taxable years beginning in 2014, bears to \$10,000”).

deduction, which requires medical expenses to exceed ten percent of the taxpayer's adjusted gross income.⁶³ This means that the medical records used to substantiate potential deductions will become irrelevant if the total expenses do not exceed the specified amount. Thus, the computational mechanics of certain deductions and credits disqualify many taxpayers who otherwise would qualify, and, as a result, the amount of tax-relevant information for those taxpayers is reduced.

2. Information Provided by Third Parties

While the taxpayer is obligated to maintain records and provide tax-relevant information to the IRS, either on the initial tax return or later by specific request,⁶⁴ the IRS is not limited to obtaining information from the taxpayer. Indeed, information about ninety-seven percent of taxpayers is provided to the IRS in routine reports from third parties.⁶⁵ For example, a taxpayer's employer is required to report payroll information to the IRS.⁶⁶ A corporation that pays a dividend to the taxpayer must report it to the IRS,⁶⁷ as do interest and royalty payors.⁶⁸ Whenever a real estate sale closes, the closing agent must report the seller's identity, the property, and the sale price.⁶⁹ And any business receiving more than \$10,000 (in cash or checks) must report the identity, address, and the Social Security Number of the payor to the IRS.⁷⁰ About

⁶³ *Id.* § 213(a) (explaining that medical expenses not otherwise covered by insurance are deductible to extent the expenses exceed ten percent of adjusted gross income).

⁶⁴ *See supra* note 30.

⁶⁵ *See* INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2012 ANNUAL REPORT TO CONGRESS 181. For example, a taxpayer's employer is required to provide payroll information to the IRS. *See* I.R.C. § 6051 (West 2014) (Receipts for employees). Similarly, payments of dividends, I.R.C. § 6042, interest, I.R.C. § 6049, and royalties, I.R.C. § 6050N, to a taxpayer obligate the payor to provide information about the payment to the IRS. Real estate closings usually obligate the closing attorney or the title company to provide the IRS information about the seller, the property, and the sales price. *Id.* § 6045(e) (West 2014). Those receiving more than \$10,000 in the course of business must report to the IRS the name, address, and the Social Security Number of the payor. *Id.* § 6050I; *see also* Treas. Reg. § 1.6050I-1 (2001).

⁶⁶ I.R.C. § 6051 (West 2014) (Receipts for employees).

⁶⁷ *Id.* § 6042.

⁶⁸ *Id.* §§ 6049, 6050N.

⁶⁹ *Id.* § 6045(e).

⁷⁰ *Id.* § 6050I; Treas. Reg. § 1.6050I-1(e)(2) (2001). In 2010, Congress vastly expanded third party reporting by requiring business taxpayers to file reports on each person from whom the business purchased more than \$600 in goods in a year. *See* Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, 124 Stat. 119, § 9006(b)(1) (amending I.R.C. § 6041(a) to require reports on amounts paid by businesses "in consideration for property."). However, this far-reaching requirement was

seventy-five items are reported by third parties to the IRS whether or not the taxpayer is audited. These items are reported as a matter of routine, not request.⁷¹

But in gathering information about the taxpayer, the IRS is not limited to routine reports. It has broad legal authority to summon information from third parties, including business contacts, employees, and advisors.⁷² Even though the attorney-client privilege and a similar privilege for accountants⁷³ are available to protect those advisors from being compelled to testify in certain situations, no protection exists if the information has been provided in connection with the preparation of a return.⁷⁴ Generally, there is neither Fourth Amendment protection for information held by third parties (including the taxpayer's lawyers or accountants),⁷⁵ nor is there Fifth Amendment protection.⁷⁶ With respect to the information

quickly repealed the following year. *See* Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Pub. L. No. 112-9, 125 Stat. 36 (repealing the addition to § 6041(a)).

⁷¹ Form 1040 Instructions summarize how to incorporate third-party provided information into the Form 1040. This information has been provided to both the taxpayer and the IRS. INTERNAL REVENUE SERV., 1040 INSTRUCTIONS 2014, at 10-11, <http://www.irs.gov/pub/irs-pdf/i1040gi.pdf>.

⁷² Generally, a summons to third parties may be issued only after the taxpayer has been given notice that contacts with third parties may be made. I.R.C. § 7602(c) (West 2014); *see also id.* § 7604; MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[1].

⁷³ I.R.C. § 7525(a) (West 2014).

⁷⁴ *See* United States v. Davis, 636 F.2d 1028, 1037 (5th Cir. 1981) (holding that communications related to preparation of client's tax returns are not privileged); *see also* United States v. Clark, 847 F.2d 1467 (10th Cir. 1988) (holding that taxpayer's nonbusiness records that taxpayer's accountant had delivered to attorney were not privileged); United States v. Brown, 349 F. Supp. 420 (N.D. Ill. 1972), *modified*, 478 F.2d 1038 (7th Cir. 1973) (explaining that an accounting firm's documents generally may be compelled because they do not fall under the work product doctrine, there is no federal accountant-client privilege, and an accountant's notes do not become privileged merely because they are based on statements made in the presence of an attorney); MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[2][b].

⁷⁵ Where a document is in the hands of a third party, there is no expectation of privacy for the taxpayer, even if the taxpayer maintains ownership of the record. *See* Couch v. United States, 409 U.S. 322, 332-33 (1973) (finding that client had no legitimate expectation of privacy for tax records held by his accountant).

⁷⁶ There is no Fifth Amendment protection for records held by accountants or lawyers. *Id.* (finding that an accountant holding the taxpayer's records was compelled to provide them because the taxpayer's Fifth Amendment privilege against self-incrimination adhered only to the taxpayer, not the accountant); Fisher v. United States, 425 U.S. 391 (1976) (compelling a lawyer holding a taxpayer's record to disclose it).

held by the taxpayer and no one else, Fifth Amendment protection against compulsion is available—but limited.⁷⁷

B. *The Tax Information Gap*

The current system of providing individual income tax-relevant information to the IRS has two substantial problems. The first is that the burden on individual taxpayers complying with the system is significant. The second is that a great many taxpayers do not comply with the system, causing a tremendous loss of tax revenue. Both of these problems are ameliorated to the extent that third parties provide information to the taxpayer (which tends to ease compliance) and the IRS (which tends to ensure compliance). Both of these problems reflect the information gap between the taxpayer and the IRS.

1. Compliance Burden

The tax compliance burden is the cost to taxpayers of attempting to report their tax liabilities in a timely manner. This requires knowing what information is tax relevant, organizing it, and being sufficiently informed as to the tax law and how to make the computations. The IRS estimates that an individual filing the Form 1040, the most commonly filed individual income tax return, will spend sixteen hours doing so.⁷⁸ The record keeping requirements are the largest component of that: eight hours.⁷⁹ The National Taxpayer Advocate has concluded that individual “taxpayers find the return preparation process so overwhelming that more than 80

⁷⁷ The Fifth Amendment is not a defense for failing to file an income tax return (e.g., when engaged in an illegal business), though the taxpayer may claim the privilege as to “the specific questions for which a valid privilege exists” so long as the taxpayer completes “the remainder of the form.” 3 WHITE COLLAR CRIME § 19:93. *See generally* Garner v. U.S., 424 U.S. 648 (1976) (holding that incriminating disclosures of gambling were admissible evidence and not compelled incrimination where they had been made on petitioner’s tax return). Tax-relevant records that have been voluntarily prepared by the taxpayer have not been compelled and thus do not qualify for Fifth Amendment protection. U.S. v. Doe, 465 U.S. 605, 612 (1984). Arguably, at least some tax-relevant records may be required and thus may not be protected by the Fifth Amendment. *See, e.g.*, M.H. v. United States, 648 F.3d 1067 (9th Cir. 2011) (holding that records related to the foreign bank accounts of a taxpayer fell within the scope of the required records doctrine). Nevertheless, the acts of “gathering, identifying, and authenticating” the tax relevant records may be testimonial and therefore privileged. *See* JOHN A. TOWNSEND, LARRY A. CAMPAGNA, STEVE JOHNSON & SCOTT A. SCHUMACHER, TAX CRIMES 238 (2008).

⁷⁸ This number does not include post-filing time, such as time spent responding to IRS requests for additional information. *Estimates of Taxpayer Burden*, 1040 INSTRUCTIONS 2014, *supra* note 71, at 97-98.

⁷⁹ *Id.*

percent pay transaction fees to help them file their returns.”⁸⁰ Tax compliance requires 7.6 billion work-hours a year.⁸¹ If it were an industry, it would employ 3.8 million employees full-time.⁸²

The compliance burden is so high because the individual is obligated to navigate a complex, regularly changing set of laws that determines what information is relevant and how it affects the taxpayer’s liability. The individual taxpayer’s gap of knowledge about the tax law, tax-relevant facts, and how to apply the law to the facts is quite understandable. The tax code has over 3.5 million words, about three times as many as it did in 1975.⁸³ In hard copy form, the regulations and summaries of administrative guidance and relevant case law take nine feet of shelf space.⁸⁴ And the statutory provisions themselves are technical and overlapping. By the National Taxpayer Advocate’s count, a taxpayer interested in correctly characterizing college education expenses must navigate eleven different provisions, each of which has its own eligibility requirements, definitions, income thresholds, phase-outs, and inflation adjustments.⁸⁵ A similar count of provisions relevant to characterizing retirement savings comes to sixteen different provisions, each with different rules.⁸⁶ And both of these categories provide *benefits* to the taxpayer. “It is not reasonable to expect the average taxpayer to learn the details of at least 27 education and retirement incentives to determine which ones provide the best fit.”⁸⁷ The burden on the taxpayer is so great that, while sophisticated taxpayers are able to find “loopholes,” unsophisticated taxpayers often overpay.⁸⁸ To illustrate the last point, the National Taxpayer Advocate pointed out that in 2006, thirty-seven million taxpayers failed to claim a credit for which they were qualified.⁸⁹

While the complexity of the tax law imposes a tremendous burden on taxpayers, the law’s requirement that third parties provide information to taxpayers significantly reduces that burden. As mentioned above, employers and others are required to report information to both the IRS and the taxpayer, and about ninety-seven percent of taxpayers have

⁸⁰ See INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2008 ANNUAL REPORT TO CONGRESS 5, <http://www.irs.gov/Advocate/National-Taxpayer-Advocate's-2008-Annual-Report-to-Congress>.

⁸¹ *Id.* at 3.

⁸² *Id.*

⁸³ *Id.* at 4.

⁸⁴ *Id.*

⁸⁵ *Id.* at 5.

⁸⁶ *Id.* at 6.

⁸⁷ *Id.*

⁸⁸ *Id.* at 11.

⁸⁹ *Id.*

information provided to them this way.⁹⁰ When third parties are obligated to provide information, they must do so in a particular format. The format requires the third party to know and apply the relevant law so that it provides not only dollar amounts to the taxpayer but characterizes the amount for the taxpayer. The most common example is the Form W-2, the tax statement issued by employers to employees. Box 1 of that form provides not just a dollar amount, but also a characterization of the amount as “wages, tips, [or] other compensation.”⁹¹ This puts the burden on the third party to characterize the amount. The Form W-2 instructions to the third party are over thirty pages.⁹² To reduce the taxpayer’s burden even further, the IRS uses line 7 of the Form 1040 to direct the taxpayer to report the amount from the W-2 box 1.⁹³ Similarly, box 4 of the W-2 informs the taxpayer how much federal income tax was withheld,⁹⁴ while the IRS uses line 62 of the Form 1040 to direct the taxpayer to insert the right amounts.⁹⁵ Box 10 of the W-2 characterizes for the taxpayer amounts paid for qualified dependent benefits, which is to be reported by the taxpayer on Form 2441, Part III. Box 12 of the W2 is the characterization for adoption benefits. This is to be reported by the taxpayer on Form 8839, line 20. Other important reports of information to the taxpayer include the Form 1098, which instructs the taxpayer how much qualified mortgage interest he or she paid in the year,⁹⁶ an amount that is deductible on line 10 of the Form 1040 Schedule A.⁹⁷ The Form 1098-E covers student loan interest reportable on line 33 of the Form 1040. Box 1b of the Form 1099-DIV characterizes payments as qualified dividends, which qualify for a special tax rate and are reported on 9b of the Form 1040. Indeed, there are over seventy-five items of information provided to the taxpayer by third parties that the Form 1040 instructions correlate with a particular line number for the taxpayer.⁹⁸ Without the pre-characterization of this information by third parties and the instructional correlation of forms by the IRS, taxpayers using the Form 1040 would spend far more than eight hours maintaining their tax records and

⁹⁰ INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2012 ANNUAL REPORT TO CONGRESS 181, <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/FY-2012-Annual-Report-To-Congress-Full-Report.html>.

⁹¹ W2 WAGE AND TAX STATEMENT 2 (2015), <http://www.irs.gov/pub/irs-pdf/fw2.pdf>.

⁹² INTERNAL REVENUE SERV., 2015 GENERAL INSTRUCTIONS FOR FORMS W2 AND W3, <http://www.irs.gov/pub/irs-pdf/iw2w3.pdf>.

⁹³ 1040 INSTRUCTIONS 2014, *supra* note 71, at 10-11.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

eight hours completing the return.⁹⁹This third-party reporting greatly reduces the compliance burden.

2. The Tax Compliance Gap Is Substantial

The tax compliance gap—the difference between the income tax liability legally owed and the amount timely paid—is about *\$450 billion* each year.¹⁰⁰ To put that into context, consider that the Department of Defense budget is about \$673 billion.¹⁰¹ The tax compliance gap is almost four times the size of the Department of the Treasury budget (which includes the IRS).¹⁰² And, it is larger than the *combined* budgets of the Small Business Administration,¹⁰³ the National Science Foundation,¹⁰⁴ the Department of Homeland Security,¹⁰⁵ the Department of the Interior,¹⁰⁶ the Department of State and Other International Programs,¹⁰⁷ the Department of Education,¹⁰⁸ the Department of Housing and Urban Development,¹⁰⁹ the National Aeronautics and Space Administration,¹¹⁰ the Department of Energy,¹¹¹ the Environmental Protection Agency,¹¹² the Department of Commerce,¹¹³ the Department of Justice,¹¹⁴ and the Department of Labor.¹¹⁵

⁹⁹ *Estimates of Taxpayer Burden*, 1040 INSTRUCTIONS 2014, *supra* note 71, at 97-98.

¹⁰⁰ Internal Revenue Serv., *IRS Releases New Tax Gap Estimates: Compliance Remains Statistically Unchanged From Previous Study* (Feb. 6, 2014), <http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study>. Some argue the tax gap is higher. *See, e.g.*, Eric Toder, *What is the Tax Gap?*, 117 TAX NOTES 367 (2007) (criticizing tax gap measurement methodology).

¹⁰¹ OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2013, at 84 (2012), <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/budget.pdf>

¹⁰² *Id.* at 167.

¹⁰³ *Id.* at 194 (about \$1.4 billion).

¹⁰⁴ *Id.* at 190 (about \$7.5 billion).

¹⁰⁵ *Id.* at 121 (about \$55 billion).

¹⁰⁶ *Id.* at 135 (about \$13 billion).

¹⁰⁷ *Id.* at 156 (about \$60 billion).

¹⁰⁸ *Id.* at 128 (about \$35 billion).

¹⁰⁹ *Id.* at 141 (about \$41 billion).

¹¹⁰ *Id.* at 185 (about \$18 billion).

¹¹¹ *Id.* at 105 (about \$35 billion).

¹¹² *Id.* at 181 (about \$9 billion).

¹¹³ *Id.* at 76 (about \$9 billion).

¹¹⁴ *Id.* at 141 (about \$37 billion).

¹¹⁵ *Id.* at 149 (about \$102 billion).

The compliance gap is attributable to non-filing, underreporting, and underpayment.¹¹⁶ Non-filing is the smallest of the three sources of the gap, responsible for about \$28 billion.¹¹⁷ It occurs when taxpayers who should file a return do not do so on time.¹¹⁸ Underpayment is the second smallest source of the gap, at \$46 billion.¹¹⁹ This is when taxpayers file the return but do not pay what is due by the due date.¹²⁰ Underreporting is the greatest source of the gap—\$376 billion).¹²¹ This occurs when taxpayers understate income or overstate exemptions, deductions, or credits.¹²²

It is clear that third-party reporting to the IRS is directly related to the taxpayers' self-reporting the item. Third-party reported information is "pivotal in causing taxpayers to be forthright in their reporting" to the IRS.¹²³ When a third party has an obligation to report payments made to the taxpayer, the taxpayer's compliance rate for the item is ninety-six to ninety-nine percent.¹²⁴ For income items with no third party reporting obligation, the taxpayer compliance rate is less than fifty percent.¹²⁵ In other words, when a taxpayer's employer provides Form W2 wage and benefit information both to the taxpayer and the IRS, or when a corporation provides Form 1099-DIV dividend information both to the taxpayer and the IRS, the taxpayer is almost certain to report it. However, when a taxpayer receives a payment that is not reported by a third party such as the receipt of cash for services or purchases, the taxpayer is unlikely to report it. When the IRS does not rely only on the taxpayer's compliance efforts in order to collect information, it collects both more information and more tax revenue. Third party information reporting not only reduces the compliance burden but also the compliance gap.

¹¹⁶ INTERNAL REVENUE SERV., *Tax Gap "Map": Tax Year 2006* (2011), http://www.irs.gov/pub/newsroom/tax_gap_map_2006.pdf.

¹¹⁷ *Id.*

¹¹⁸ INTERNAL REVENUE SERV., *Understanding the Tax Gap* (July 16, 2014) <http://www.irs.gov/uac/Understanding-the-Tax-Gap>.

¹¹⁹ *Tax Gap "Map": Tax Year 2006*, *supra* note 116.

¹²⁰ *Understanding the Tax Gap*, *supra* note 118.

¹²¹ *Tax Gap "Map": Tax Year 2006*, *supra* note 116.

¹²² *Understanding the Tax Gap*, *supra* note 118.

¹²³ Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371, 371 (2007).

¹²⁴ INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2011 ANNUAL REPORT TO CONGRESS 285-86, <http://www.irs.gov/Advocate/National-Taxpayer-Advocate's-2011-Annual-Report-to-Congress>; Schulman, *supra* note 1.

¹²⁵ NATIONAL TAXPAYER ADVOCATE 2011 ANNUAL REPORT TO CONGRESS, *supra* note 124, at 285-86

II. Surveillance to Close the Information Gap

In this Part, I predict that over the next twenty-five years, the IRS will increasingly rely on surveillance technologies to reduce the compliance burden and compliance gap. Both the compliance burden and gap have received attention from the U.S. Senate Finance Committee, the IRS Commissioner, the National Taxpayer Advocate, tax scholars, and politicians. Their call to harness new technologies to solve these problems must now be considered in the context of the information technology revolution. Whether surveillance technologies are used to eliminate the compliance burden and the compliance gap ultimately will be a matter of political will, specifically including the will to reform the tax system to fit the technologies.

A. *The Information Gap Problem*

As outlined in Part I, the tax information gap causes two problems: the compliance burden and the compliance gap. The compliance burden is the difficulty taxpayers suffer due to inadequate information about how to comply with and maintain the records for complying with the tax law. The compliance gap is how much federal tax revenue is lost through noncompliance. The tax compliance burden amounts to 7.6 billion hours a year of taxpayer time,¹²⁶ and the tax compliance gap costs the federal revenue \$450 billion a year.¹²⁷

Both the compliance burden and compliance gap have received considerable political attention. As Chairman of the Senate Finance Committee in 2015, Senator Orin Hatch described the costs of compliance as equal to the economy of New Zealand.¹²⁸ Senator Ron Wyden described the compliance process as “painful.”¹²⁹ In 2011, the Senate Finance Committee held hearings on the tax gap, during which Senator Hatch

¹²⁶ NATIONAL TAXPAYER ADVOCATE 2008 ANNUAL REPORT TO CONGRESS, *supra* note 80, at 3.

¹²⁷ See *supra* note 101 and accompanying text.

¹²⁸ *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform: Hearing Before the S. Comm. on Finance*, 114th Cong. (2014) (statement of Sen. Hatch), <http://www.finance.senate.gov/imo/media/doc/3.10.2015%20RELEASE%20Hatch%20Statement%20a%20Finance%20Hearing%20on%20Simplifying%20the%20Tax%20Code1.pdf> (describing the costs of tax compliance as larger than the economy of New Zealand).

¹²⁹ *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform: Hearing Before the S. Comm. on Finance*, 114th Cong. 1 (2014) (statement of Sen. Wyden), <http://www.finance.senate.gov/imo/media/doc/031015%20Wyden%20Says%20Comprehensive%20Reform%20Needed%20to%20Simplify%20Tax%20Code%20for%20Middle%20Class%20Americans.pdf> (describing the tax returning filing process as painful).

testified that the “[t]ax gap is the great white whale of deficit reduction. If only the government was able to collect what it is owed, our deficits would be reduced significantly.”¹³⁰ Senator Max Baucus identified increased information reporting as one of the most promising solutions to closing the tax gap, but worried that increasing information reporting would inappropriately increase the burden on the information-reporting third parties.¹³¹ He hoped there would be “ways the IRS can harness new technology.”¹³²

IRS Commissioner Doug Schulman articulated a specific vision of how new technology could harness more information and improve tax administration. Commissioner Schulman described the IRS as “an information intensive enterprise,” saying that what “really matters” to the IRS is “the organization of data and ultimately the knowledge and intelligence we extract from the information.”¹³³ In this context, he articulated his “long-term vision” that “the IRS could get all information from third parties before individual taxpayers filed their returns. Taxpayers or their return preparers could then access that information, via the Web, to prepare their tax returns.”¹³⁴ Echoing the Commissioner and tax scholars,¹³⁵ the National Taxpayer Advocate Nina Olsen has called for third parties to electronically report information to taxpayers to aid them in preparing their returns.¹³⁶ However, she went one step further in her recommendations by suggesting that the IRS use third-party reported information to prepare returns for taxpayers.¹³⁷ On this point, she echoed President Barack Obama’s campaign call to provide “taxpayers the option of pre-filled tax forms to verify, sign and return.”¹³⁸

¹³⁰ *Id.*

¹³¹ *Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What’s Due: Hearing Before the S. Comm. on Finance*, 112th Cong. (2011) (statement of Sen. Baucus).

¹³² *Id.* at 2.

¹³³ Schulman, *supra* note 1.

¹³⁴ *Id.*

¹³⁵ *See, e.g.*, Jay A. Soled, *Call for the Gradual Phase-Out of All Paper Tax Information Statements*, 10 FLA. TAX REV. 345 (2010) (calling for third parties to provide tax data at a secure IRS website taxpayers could use to prepare their tax returns, creating administrative efficiencies and simplifying the return preparation process).

¹³⁶ INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2009 ANNUAL REPORT TO CONGRESS 343, <http://www.irs.gov/Advocate/National-Taxpayer-Advocate's-2009-Annual-Report-to-Congress>.

¹³⁷ *Id.* at 344.

¹³⁸ Barack Obama’s Comprehensive Tax Plan, 3, *available at* http://halebob.com/Obama/Factsheet_Tax_Plan_FINAL.pdf.

B. *Information Technology Revolution and the Information Gap*

These proposals for using technology to leverage tax information for taxpayers have to be considered in light of the revolution in information technology. If the IRS could collect and analyze all tax-relevant information, it could lower both the compliance gap and compliance burden. Presumably the coming ubiquity of smart devices and the ability to process the massive quantities of data generated by those devices¹³⁹ could enable the IRS to do so. How might the “minutely detailed records of our lives” created by these technologies be used in tax compliance?¹⁴⁰ Imagine that every day “rivulets of information stream into electronic brains” at the IRS “to be sifted, sorted, rearranged, and combined in hundreds of different ways” to determine tax consequences.¹⁴¹ While the use of this information for tax compliance purposes might be novel, those rivulets of information already exist and are expanding. These streams of information already flow from and through government agencies and private companies. Government agencies, “industry, employers, hospitals, transportation providers, Silicon Valley, and individuals” are all “linked, shared, and integrated.”¹⁴² They use the “same technologies and techniques” to gather information so that the “digital fruits” can be shared between them.¹⁴³ And over the next twenty years, those shared rivulets of information will swell with the “growing gush of data” from the “internet of things.”¹⁴⁴

Other government agencies, such as the NSA have taken the lead in pursuing this growing gush of data, but the IRS may follow their lead. Reportedly, the NSA’s goal is intercepting, sorting, and analyzing much of the world’s internet activities.¹⁴⁵ The quantity of information processed by the NSA is tremendous—it is estimated that every fourteen seconds, the NSA processes information equal to all of the information in the Library of Congress.¹⁴⁶ But the NSA is not alone. The government works with private companies in a

¹³⁹ Big Data is shorthand for the technology that can process vast quantities of data in very short times, mining the data for patterns—especially patterns useful for predictions. It can be used to analyze physical, transactional, and behavioral data about people. Julie E. Cohen, *What Privacy Is For*, 126 HARV. L. REV. 1904, 1920, 1931 (2013).

¹⁴⁰ Richards, *supra* note 4, at 1934.

¹⁴¹ Solove, *supra* note 17, at 1394.

¹⁴² Citron & Gray, *Total Surveillance*, *supra* note 5, at 262.

¹⁴³ Richards, *supra* note 4, at 1958.

¹⁴⁴ Clarke, *supra* note 18.

¹⁴⁵ Richards, *supra* note 4, at 1934.

¹⁴⁶ Neil M. Richards & Jonathan H. King, *Big Data Ethics*, 49 WAKE FOREST L. REV. 393, 401 (2014).

public-private partnership designed to provide “contemporary and perpetual access to details about everywhere we go and everything we do, say, or write.”¹⁴⁷ Over the next twenty-five years, as we move towards 2040, the year by which these details may be known to the agencies and companies, presumably the IRS will be among those entities pursuing this growing gush of data. This prospect gives privacy law and tax law scholars a good deal to discuss.¹⁴⁸

C. *Predicting a Tax Surveillance System*

I predict that over the next twenty-five years surveillance technologies will be used to reduce the compliance burden and compliance gap, at least to some extent. The growing gush of data is too valuable to ignore when contemplating how to solve the compliance burden and gap. But technological and political factors will either pave or block the way for increasing surveillance to improve tax administration. Ultimately, it is the political factors that will determine the extent to which the IRS is enabled to capture the growing “rivulets of information” streaming “into electronic brains.”¹⁴⁹

1. The IRS and the Growing Gush of Data

Consider how the IRS might use the growing gush of data. In a world where government agencies and private companies achieve “perpetual access to details about everywhere we go and everything we do, say, or write,”¹⁵⁰ we can imagine those details flowing through electronic brains at the IRS for tax analysis. With information about a taxpayer’s location each day and night, travel, and purchase patterns and those of her family members, colleagues, and customers, the IRS might determine the likelihood that a particular residence is the taxpayer’s principal residence,¹⁵¹ that she regularly conducts business activities within it,¹⁵² that some of those with whom

¹⁴⁷ Gray & Citron, *Quantitative Privacy*, *supra* note 4, at 64.

¹⁴⁸ Clarke, *supra* note 18.

¹⁴⁹ Solove, *supra* note 17, at 1394.

¹⁵⁰ *Id.*

¹⁵¹ For example, the number of days the taxpayer lived in his or her home and the proximity of the home to the taxpayer’s place of employment, religious congregation, social clubs etc., may be necessary to determine the tax consequences on the home’s sale. I.R.C. § 121 (West 2014) (excluding gain from sale of principal residence); Treas. Reg. § 1.121-1(b)(2) (2002) (determining which property is taxpayer’s principal residence).

¹⁵¹ Treas. Reg. § 1.121-3(e)(2) (2004) (describing sale by reason of unforeseen circumstances—specific event safe harbors).

¹⁵² The nature of any business activities regularly conducted in a taxpayer’s home (and the square footage of the home in which such activities occur, such as meeting with clients) determines if any part of the home expenses are deductible as a home office. I.R.C. § 280A(a), (c) (West 2014)

she shares the residence are dependents¹⁵³ or that one is a former spouse from whom she is legally separated,¹⁵⁴ or that certain meal expenses¹⁵⁵ are for business rather than personal purposes.¹⁵⁶ By comparing a taxpayer's business expenses with those of taxpayers in the same line of business, the IRS might determine the likelihood that an expense was "ordinary" and "necessary", and therefore, deductible.¹⁵⁷ By analyzing what a taxpayer reads (where and for how long a taxpayer's gaze falls on certain screens),¹⁵⁸ the entertainment a taxpayer pursues, and where and how much time a taxpayer spends in relevant places, the IRS might determine the likelihood that certain

(disallowing deductions for business use of homes subject to exceptions); Prop. Treas. Reg. § 1.280A-2(a) (deductibility of expenses attributable to business use of home).

¹⁵³ Determining if a child is a dependent may be especially important when the child's parents are divorced. *See* I.R.C. § 152(c)(1)(B) (West 2014) (defining a qualifying child as having the same principal place of abode as taxpayer for more than one-half of year); Treas. Reg. § 1.152-1(b) (1971) (providing general definition of a dependent and listing special circumstances of absences of less than six months).

¹⁵⁴ Payments to a separated spouse with whom one is actually living is relevant to determining the tax consequences of the payment. *See* I.R.C. § 71(b)(1) (West 2014) (defining alimony and separate maintenance payments).

¹⁵⁵ If you incurred and paid for meal expenses at the same time, while in the same restaurant as those who paid your professional fees in the recent past (or do in the near future), it seems likely the meal was for business purposes, especially if there were not additional entertainment expenses in the same evening. *See* I.R.C. § 274(a) (West 2014) (disallowing certain entertainment expenses); *id.* § 274(e) (listing exceptions, such as for meetings of employees or shareholders).

¹⁵⁶ Information revealing that you travelled to a distant city, paid fees for a conference where others in your profession also paid fees, stayed in a hotel in which other professional stayed the same number of nights, and did not incur expenses at nearby theme parks, day spas, or night clubs, indicates that it is likely the travel was primarily for business purposes and thus deductible. *See id.* § 162(a)(2) (describing deductible travel expenses for trade or business); Treas. Reg. § 1.162-2(b) (1960) (determining whether a trip is primarily business or personal).

¹⁵⁷ For example, a business expense must be "ordinary and necessary," based on the normal expenses of those in the taxpayer's line of business. For compensation paid to be deductible, it must be "reasonable," which is also based on the taxpayer's line of business. I.R.C. § 162(a) (West 2014) (stating reasonable compensation that is ordinary and necessary is deductible); Treas. Reg. § 1.162-7(b)(3) (clarifying that "reasonably" generally means as would ordinarily be paid for like services by like enterprises under like circumstances); *see also* *Welch v. Helvering*, 290 U.S. 111 (1933) (holding that business expenses must be customary or expected in line of business).

¹⁵⁸ The Kindle and Nook already track reader behavior, down to the specific pages on which a reader lingers. Richards, *supra* note 4, at 1939.

expenses (e.g., for raising horses) were non-deductible hobby expenses rather than deductible business expenses.¹⁵⁹

Over the next twenty-five years, it is likely that there will be efforts to meet the need for more tax-relevant information with technologies that can gather it efficiently and analyze it reliably. The result could be technologically pre-filled returns ready for the taxpayer to verify, sign and submit. While there are about 145 million individual tax returns filed each year, potentially tax-relevant information would need to be gathered on anyone who may have income in order to determine if the income meets the threshold for filing. As the tax system has increasingly become used for purposes other than revenue-collection—such as delivering welfare payments through the Earned Income Tax Credit or health care coverage through the Affordable Care Act¹⁶⁰—information on many individuals who have no income would need to be gathered as well. This routine, systematic collection of data on such a large population—this surveillance¹⁶¹ of the population—could eliminate all compliance burdens on individuals, as well all routes of evasion.

¹⁵⁹ The line between deductible business expenses and non-deductible personal expenses is particularly difficult to discern when the taxpayer has a hobby that generates income, even though the taxpayer is pursuing the hobby for pleasure rather than profit. *See* Treas. Reg. § 1.183-1 (1960) (stating relevant factors for determining if activity is engaged in for profit include taxpayer's expertise, time devoted to activity, manner of carrying it out, success in other activities, and elements of personal pleasure or recreation).

¹⁶⁰ The Earned Income Tax Credit program is the second largest cash or near-cash assistance program for low-income Americans. It is a refundable credit, meaning it not only reduces a recipient's income tax liability but results in a cash payment to the extent the credit exceeds the liability. More than 26 million American households received benefits in 2015, totaling \$60 billion. Tax Policy Center, *Taxation and the Family: What is the Earned Income Tax Credit?* in THE TAX POLICY BRIEFING BOOK, available at <http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm> (last visited August 11, 2015). The Affordable Care Act is primarily administered by the IRS. The tax return is used to report health insurance coverage to the IRS. The IRS also receives the shared responsibility payments. Internal Revenue Serv., *Individual Shared Responsibility Provision*, <http://www.irs.gov/Affordable-Care-Act/Individuals-and-Families/Individual-Shared-Responsibility-Provision> (last updated July 20, 2015).

¹⁶¹ In defining surveillance, Neil Richards considers four markers: First, it is focused on learning information about individuals. Second, surveillance is systematic; it is intentional rather than random or arbitrary. Third, surveillance is routine—a part of the ordinary administrative apparatus that characterizes modern societies. Fourth, surveillance can have a wide variety of purposes—rarely totalitarian domination, but more typically subtler forms of influence or control.

Richards, *supra* note 4, at 1937.

2. Technological Feasibility

This prediction naturally requires an inquiry into what the relevant surveillance technology would require and whether such a “Tax Surveillance System” could become technologically feasible over the next twenty-five years. It seems most likely that “barring some civilization-threatening disaster, the next 25 years of cyberspace will see a growing gush of data” that will be collected and analyzed by “an increasingly rapid spreading of interconnected devices into every aspect of our lives, in our cars, throughout our homes, and, indeed, into our bodies.”¹⁶² This internet-of-things is predicted to include fifty billion objects by 2020.¹⁶³ By 2040 it “could be a given” that all of our activities are known by governmental and corporate entities.”¹⁶⁴ Of course, accurately predicting the specifics of future technological developments is notoriously difficult.¹⁶⁵ Only time will tell. But in the meantime private companies are betting that “Big Data” and the internet-of-things and other technological advancements will be transformative.

Yet, while these may be tremendously useful for companies seeking profit, it may be that the tax system’s need for these advancements would be significantly different. It may turn out that much of what private companies are best at doing would not easily transfer to tax surveillance. Private companies aim to monitor, predict, and change consumer behavior. Their analysis does not require legal-standard accuracy. For example, a retailer’s attempt to determine who is especially vulnerable to specific marketing efforts may only be accurate two-thirds of the time, yet be exceptionally profitable and impose no harm on the remaining one-third of subjects targeted. However, the Tax Surveillance System would need to analyze tax consequences within legal standards of accuracy. Errors might violate taxpayers’ legal rights, result in economic

¹⁶² Clarke, *supra* note 18; see also generally Nick Bilton, *Intruders for the Plugged-In Home, Coming in Through the Internet*, N.Y. TIMES, June 1, 2014, <http://bits.blogs.nytimes.com/2014/06/01/dark-side-to-internet-of-things-hacked-homes-and-invasive-ads>; Nick Bilton, *Some Predictions About the Internet of Things and Wearable Tech from Pew Research*, N.Y. TIMES, May 14, 2014, <http://bits.blogs.nytimes.com/2014/05/14/some-predictions-about-the-next-decade-from-pew-research>; Don Clark, ‘Internet of Things’ in Reach, WALL ST. J., Jan. 5, 2014, <http://www.wsj.com/articles/SB10001424052702303640604579296580892973264>.

¹⁶³ Clark, *supra* note 18.

¹⁶⁴ *Id.*

¹⁶⁵ For analysis of the general overconfidence of experts with respect to artificial intelligence, especially with respect to timeline predictions, see generally Stuart Armstrong, Kaj Sotala & Seán S.Ó hÉigeartaigh, *The Errors, Insights and Lessons of Famous AI Predictions—And What They Mean for the Future*, 26 J. EXPERIMENTAL & THEORETICAL ARTIFICIAL INTELLIGENCE 317 (2014).

drag (over-taxing) or windfall (under-taxing), and even increase tax administration and compliance costs. The profit-driven data techniques that private companies develop over the next twenty-five years likely will be of some use in designing the tax system, but quite different techniques also would have to be developed to make tax surveillance feasible.

The primary problem the Tax Surveillance System would face is developing a system sufficiently intelligent to identify tax-relevant information and issues and to find, interpret, and apply the appropriate law. The system would not only need to surveil a taxpayer's purchases, but also to determine the likelihood that the purchase was related to the taxpayer's business and, if so, whether it should be deducted or capitalized.¹⁶⁶ Even these basic issues can challenge an experienced tax professional; automating a process to do this work may be impossible. Any undertaking to "automate" legal decision-making is tremendously complex and requires multiple types of expertise. When automating legal decision-making, programmers must make decisions in order to interpret the law and then translate it into computer code, and they almost always lack the legal and policy expertise to do this.¹⁶⁷ Even if a programmer has the requisite expertise, computer codes have a more limited vocabulary than the law.¹⁶⁸ The combination of this limited expertise and limited vocabulary has led to substantial distortions of the law when decision-making has been automated in other areas.¹⁶⁹ And coding tax law would be especially complex. The complexity of tax law is notorious.¹⁷⁰ For example, some provisions require not only interpreting text, but also interpreting Congressional assumptions and purposes.¹⁷¹ In the tax context, basic issues are sometimes exceptionally complicated; in the coding world, even basic factual issues, like correctly identifying individuals,

¹⁶⁶ Compare I.R.C. § 162 (West 2014) with I.R.C. § 263 (West 2014).

¹⁶⁷ Danielle Keats Citron, *Technological Due Process*, 85 WASH. U. L. REV. 1249, 1261 (2008).

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 1255-62 (arguing that mistakes of this type led to hundreds of thousands of incorrect benefits determinations in the Colorado public benefits system to hundreds of thousands of incorrect benefits determinations).

¹⁷⁰ Bradford L. Ferguson, Frederic W. Hickman & Donald C. Lubick, *Reexamining the Nature and Role of Tax Legislative History in Light of the Changing Realities of the Process*, 67 TAXES 804, 806 (1989) (describing the I.R.C. as the "lengthiest, most complex, most internally interrelated statute on the books today").

¹⁷¹ Treas. Reg. § 1.1002-1(b) (as amended in 1960) (providing that non-recognition provisions are "not available either beyond the words or the underlying assumptions and purposes" of the provision).

have posed significant problems for automation projections.¹⁷² Consider how complicated identifying the taxpayer becomes in the partnership context. Although a partnership has a taxpayer identification number, earns income, and pays expenses, those items of income and deductions are allocated to the partners to be reported under their own taxpayer identification numbers.¹⁷³ These allocations may not follow the same formula for each item, and, as a further complication, the formulae may not be set at the time the underlying transaction occurs.¹⁷⁴

But tax law is not only complex—it is uncertain. The length and detail of the Code notwithstanding, there is limited and conflicting authority on many points of law. How would the Tax Surveillance System be designed to manage such legal complexity and uncertainty? It may be that, absent substantial tax reform as discussed in Section III, it simply could not be done.

Another technological problem that would impede development of a Tax Surveillance System is the security of the system. First, the system would need to be secured from inappropriate manipulation by the taxpayer. Second, the information would need to be secured from inappropriate access by IRS and other government employees. History has shown such inappropriate access to be a recurring problem.¹⁷⁵ Third, the information—and its revelation of maps of activities and webs of relationships—would need to be secured from hackers with various motivations: those interested in identity theft; those interested in espionage; and those interested in detecting vulnerabilities in order to extract payment.¹⁷⁶

¹⁷² For example, identification problems in the automated no-fly lists are notorious—and difficult to correct. Citron, *supra* note 167, at 1273-75.

¹⁷³ See I.R.C. § 701 (West 2014) (Partners, Not Partnership, Subject to Tax).

¹⁷⁴ See *id.* § 702 (Income and Credits of Partner).

¹⁷⁵ See generally U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-15-337, INFORMATION SECURITY: IRS NEEDS TO CONTINUE IMPROVING CONTROLS OVER FINANCIAL AND TAXPAYER DATA (2015); Stephen W. Mazza, *Taxpayer Privacy and Tax Compliance*, 51 UNIV. KANSAS L. REV. 1065, 1102-03 (2003).

¹⁷⁶ For discussion of the range of contemporary data security threats, see Robert Beckhusen, *Pentagon Warns: 'Pervasive' Industrial Spying Targets U.S. Space Tech*, WIRED, Dec. 13, 2012, <http://www.wired.com/2012/12/space-espionage>; Andy Greenberg, *Kevin Mitnick, Once the World's Most Wanted Hacker, Is Now Selling Zero-Day Exploits*, WIRED, Sept. 27, 2014, <http://www.wired.com/2014/09/kevin-mitnick-selling-zero-day-exploits>; Kim Zetter, *Hacker Lexicon: What Is a Zero Day?*, WIRED, Nov. 11, 2014, <http://www.wired.com/2014/11/what-is-a-zero-day>; and Kim Zetter, *How to Protect Yourself From Big Bank-Card Hacks*, WIRED, Sept. 10, 2014, <http://www.wired.com/2014/09/avoid-bank-card-breach-hassle>.

Technologically securing the system would be no small design feat and would be essential to such a system's feasibility.¹⁷⁷

A workable Tax Surveillance System would not drop into place fully formed. Implementing such a massive program would have to be piecemeal. The sequencing of program pieces would be important not only for technical purposes,¹⁷⁸ but also for educating taxpayers and training government employees. Acknowledging that the practicalities would require such a system to arrive gradually makes its arrival more plausible. Consider the incremental steps such a system might take.

The first step might be merely greatly expanding third-party reporting requirements. As discussed above, these are essential to tax administration,¹⁷⁹ are widespread, and are increasing.¹⁸⁰ Both the IRS Commissioner and the National Taxpayer Advocate have envisioned widespread electronic reporting of information by third parties to the IRS as a means to reduce the compliance burden and the compliance gap. This information would be reported to a site, which would then provide the information to taxpayers.

A second step might be the integration of private return preparation services into the project on a voluntary basis. A very pale version of this already exists insofar as some taxpayers use return preparation software that downloads information from third parties.¹⁸¹ These companies might next develop ways to reduce their taxpayer-customer's record-keeping requirements throughout the year by monitoring their location and travels, online activities, and electronic payment transactions, electronically recording relevant information to

¹⁷⁷ The current system has become an appealing target—and is a vulnerable one. Jada F. Smith, *Cyberattack Exposes I.R.S. Tax Returns*, N.Y. TIMES, May 26, 2015, <http://www.nytimes.com/2015/05/27/business/breach-exposes-irs-tax-returns.html?ref=business&r=0>.

¹⁷⁸ In Colorado, the failure to test run the automated benefits system led to disastrous consequences. Citron, *supra* note 167, at 1273-75.

¹⁷⁹ Compliance for items for which there is a third-party reporting requirement is about double what it is for items without third party reporting. See INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE 2011 ANNUAL REPORT TO CONGRESS 285-86, <http://www.irs.gov/Advocate/National-Taxpayer-Advocate's-2011-Annual-Report-to-Congress>.

¹⁸⁰ See, e.g., I.R.C. § 6050W (West 2014) (creating obligation for third parties, such as credit card companies and Paypal, to report transactions exceeding certain thresholds); see also Byron M. Huang, *Walking the Thirteenth Floor: The Taxation of Virtual Economies*, 17 YALE J.L. & TECH. 224, 264-65 (2015) (describing how information reporting from services like Paypal can be used to increase compliance with taxes in an online context)

¹⁸¹ See, e.g., *Import Fidelity Tax Information into Turbo Tax*, FIDELITY, <https://www.fidelity.com/taxes/turbotax-discount/import> (last visited Apr. 13, 2015) (showing that Turbo Tax and similar products already allow downloading from third parties).

address issues not covered by the payor-payee relationship usually found in third-party reporting situations.

Both expanding third-party reporting requirements and integrating private return preparation services might cover a great many individuals, including those whose tax-relevant information is mostly already subject to third-party reporting obligations, those who claim only the standard deductions, and those who use tax return preparation software that electronically files the return with the IRS. With facilitation by the IRS, third-party information reporters and return-preparation software designers could cooperate and achieve a significant reduction in these taxpayers' compliance burden. But these taxpayers—the ones with a high level of information being reported by third parties and claiming only the standard deduction—already have a low compliance burden. And they already have a high compliance rate.

Ultimately, it is the taxpayers with low levels of third-party-reported information and low levels of compliance that must be included if the Tax Surveillance System is to serve its purposes. It is this project that would require extraordinary technological developments, not only with respect to gathering the information but, more so, with respect to the artificial legal intelligence necessary to use the information. As a practical matter, discussed in the next Section, this would require substantive tax reform in order to fit the law's information requirements into what can be best gathered and processed with the new technology.

3. Political Feasibility

Ultimately, the arrival of a Tax Surveillance System would not be so much a matter of technological capability as it would be of political will. Political forces could modify the law to fit within the technological capabilities that emerge over the next twenty-five years. Yet, like technological feasibility, only time will tell whether such a system could become politically feasible.

Senator Orrin Hatch identified the most politically sensitive issue when addressing the Senate Finance Committee. He pointed out that the “government could close the tax gap entirely by putting IRS agents in every family's living room and in every small business,” but, he said, “this is a price that a liberty loving people, and their representatives, are rightly unwilling to pay.”¹⁸² Politically, how would the benefits of lowering the compliance burden and closing the compliance

¹⁸² *Tax Complexity, Compliance, and Administration*, Statement of Sen. Hatch, *supra* note 128.

gap be balanced with concerns over the electronic equivalent of IRS agents in every family's living room?

It is not clear how the anti-tax political forces would react to such a proposal. Closing the tax gap, as Senator Hatch said, is the "great white whale" of deficit reduction. Collecting all of what is owed rather than only a fraction of it obviously would allow rates to be lowered without lowering the revenue collected. The anti-tax political forces articulate their concerns in both economic terms¹⁸³ and philosophical objections.¹⁸⁴ Those motivated by economic concerns generally oppose the current income tax base or current rates. They are convinced that the structure of one, the other, or both undermines economic growth. Those whose anti-tax sentiment is more ideological, on the other hand, are committed to reducing the federal government. And that commitment presumably would be threatened at least as much, if not more, by federal surveillance programs as by federal taxing and spending.

Ultimately, the Tax Surveillance System debate would become a matter for popular support or resistance. Would voters be more motivated by the appeal of a lower deficit, easier compliance, and significant tax reform, or by fear of widespread surveillance? The strong libertarian impulse among some Americans¹⁸⁵ would be at odds with moving towards a Tax Surveillance System, regardless of the appeal to change details of the tax system. Indeed, the words "Tax Surveillance System" may conjure nightmares.¹⁸⁶ But popular opposition may be broader than political libertarianism. Many might be opposed to the "surveillant symbiosis" between government and big companies that may lead to the rise of the "surveillance-industrial complex."¹⁸⁷

¹⁸³ Mitt Romney is one example of this. See Brian Montopoli, *Analysis: Romney Tax Plan Strongly Favors the Rich*, CBS NEWS, Mar. 2, 2012, <http://www.cbsnews.com/news/analysis-romney-tax-plan-strongly-favors-the-rich> ("Romney and his Republican allies have long argued that tax cuts will stimulate the economy").

¹⁸⁴ One example of this is Grover Norquist, who said "I don't want to abolish government. I simply want to reduce it to the size where I can drag it into the bathroom and drown it in the bathtub." John P. Avlon, *Republicans Wisely Break with Grover Norquist*, CNN, Nov. 28, 2012, <http://www.cnn.com/2012/11/26/opinion/avlon-grover-norquist>.

¹⁸⁵ Aaron Blake, *Poll: 22 Percent of Americans Lean Libertarian*, WASH. POST, Oct. 29, 2013, <http://www.washingtonpost.com/blogs/post-politics/wp/2013/10/29/poll-22-percent-of-americans-lean-libertarian> (reporting that twenty-two percent of Americans lean libertarian).

¹⁸⁶ For some Christians, it might especially be a nightmare if the surveillance involved biometric technology, which would dovetail with the apocalyptic narrative of Mark of the Beast (a physically imprinted number for commercial transactions). *Revelation* 13:14-17.

¹⁸⁷ For perhaps the first use of this term, see JAY STANLEY, ACLU, *THE SURVEILLANCE-INDUSTRIAL COMPLEX: HOW THE AMERICAN GOVERNMENT IS CONSCRIPTING BUSINESSES AND INDIVIDUALS IN THE CONSTRUCTION*

While anti-surveillance sentiment may be strong and could eventually triumph, as a practical matter, most Americans are not very motivated to resist being monitored.¹⁸⁸ It may be that within the next twenty-five years, surveillance for tax compliance purposes will come to be seen as no big deal. The Tax Surveillance System agenda seems most likely to be settled by events, not debates. If Americans continue to be habituated to surrender privacy for services, and if doing so continues to seem risk-free,¹⁸⁹ then the burden-free compliance service offered through tax surveillance likely will be seen as acceptable. If, however, Americans begin to experience more harms from surrendering their privacy, resistance to increased surveillance seems more likely. Widespread actual harms may convince Americans to protect their personal information. These harms may come in a number of forms: credit and cash access problems caused by data breaches; automated mistakes with irreparable consequences; weariness with the psychic weight of ongoing surveillance; shifts in power between the police and the policed; incidents of stalkers, kidnappers, and murderers taking advantage of electronically accessible personal information. Or, it may be a handful of incidences of terrorists or enemy states doing so.¹⁹⁰ Unless the incidents and awareness of actual privacy harm become widespread, the impulse to exchange personal information for personal convenience likely will continue to grow unchecked. And if this continues, it seems likely that within twenty-five years, the

OF A SURVEILLANCE SOCIETY (2004), http://www.aclu.org/files/FilesPDFs/surveillance_report.pdf.

While many Americans express concern for their privacy, only a very small number say they have actually changed their behavior to avoid being tracked. *Americans' Attitudes About Privacy, Security and Surveillance*, PEW RESEARCH CENTER (May 20, 2015), <http://www.pewinternet.org/2015/05/20/americans-attitudes-about-privacy-security-and-surveillance>.

¹⁸⁸ Currently, people see the internet of things as a “gee-whiz phenomenon.” Later, they will begin to consider potential problems, like the ability of a hacker to take control of an internet-of-things-connected house or car. Or they might begin to wonder, “why is my toaster spying on me?” Bilton, *supra* note 162.

¹⁹⁰ See *ISIS Uses Social Media to Target Military Families*, KTAR NEWS, Oct. 2, 2014, <http://ktar.com/95/1771653/ISIS-uses-social-media-to-target-military-families> (reporting that the Army Threat Integration Center released a bulletin warning military families and listing precautions to take); *ISIS Threat at Home: FBI Warns US Military About Social Media Vulnerabilities*, ABC NEWS, Dec. 1, 2014 (providing warning from security agencies to military members to scrub social media accounts of information that might be used to target them); *As ISIS Threats Online Persist, Military Families Rethink Online Lives*, CNN, Mar. 23, 2015, <http://www.cnn.com/2015/03/23/us/online-threat-isis-us-troops> (reporting military members and their family members' concern over use of online media information to target them).

tradeoff between surveillance and lower deficit, tax reform, and burden-free compliance will favor surveillance.

III. Discussing, Debating, and Researching Surveillance and Taxation

In Part I, I described the current system for reporting taxpayer information to the IRS and the information-related compliance burden and gap problems. In Part II, I predicted that, over the next twenty-five years the IRS will be among the agencies and private companies trying to capture the growing gush of data. In this Part, I recommend several lines of research, discussion, and debate about the IRS's pursuit of the data gush. The recommendations relate to protecting taxpayer privacy and autonomy, determining the extent of legal authority and constitutional limits and the need to coordinate various statutes, and the substantive reform that would be necessary to create tax law that would be well served by a Tax Surveillance System.

A. *Privacy and Autonomy*

The prospect of a Tax Surveillance System raises significant concerns about the privacy of taxpayers. A great deal of the research agenda concerning how the information technology revolution should affect tax administration must focus on protecting the privacy of the taxpayers, even while gathering and analyzing all of their tax-relevant information. Some part of the solution to these problems would be reducing and refining what is considered tax relevant. But even within the settled-upon scope of information that is necessary to collect, the agenda should determine how best to design a surveillance system that values taxpayer privacy.

Privacy is most commonly understood by scholars to be an individual's interest in how his or her personal information is collected, processed, and used.¹⁹¹ If privacy is the interest in regulating the flow of personal information, the information revolution's shrinking of how much information can be kept secret does not mean that "the age of privacy is over."¹⁹² Rather, it means it is the beginning of an age in which privacy is more important than ever. The more personal information is collected, processed, and used, the more important an individual's interest in managing how this happens. Regarding privacy merely as the ability of an individual to keep information secret obscures rather than reveals what is most

¹⁹¹ Daniel Solove describes the "control" theory of privacy as one of the predominant contemporary theories of privacy and one traceable to John Locke. Daniel J. Solove, *Conceptualizing Privacy*, 90 CAL. L. REV. 1109-1115 (2002).

¹⁹² Richards & King, *supra* note 146, at 409 (quoting Mark Zuckerberg).

pressing about privacy and the information technology revolution.

Of course, the interest in controlling personal information was not generated by a technological revolution. Controlling personal information has always helped us regulate our social relationships and exercise our individual autonomy. Through controlling what we reveal to others, we control the degree of intimacy.¹⁹³ Our most intimate relationships tend to be those in which we have shared a “slow process of mutual revelation.”¹⁹⁴ In social settings, privacy is our claim on controlling information about ourselves. It is valued in that it guides the development of our personal relationships.¹⁹⁵ Privacy is also valued because it provides “breathing room” for the development of our own personhood.¹⁹⁶ It is within this breathing room—this zone of privacy—that we are able to “develop and exercise” meaningful autonomy.¹⁹⁷ Without privacy, we self-censor, suffer embarrassment, become inhibited, and experience “powerlessness, vulnerability, and dehumanization.”¹⁹⁸

But privacy is not an individualistic value. Protecting autonomous zones in which individuals can flourish with limited intrusiveness benefits society.¹⁹⁹ Protecting an individual’s autonomy redounds to the benefit of a free society through the flourishing of expression, innovation, experimentation, reflective citizenship, and a vital culture.²⁰⁰ Without privacy protection, individual activities that contribute to the greater public good are impeded.²⁰¹ A free society “ignores privacy at its peril.”²⁰²

A substantial part of the research agenda related to taxation and surveillance should be dedicated to determining how to gather and analyze tax-relevant information without losing the public good of privacy. How should a system be designed to harvest the right information while respecting privacy zones in which taxpayers have breathing room and are not dehumanized or made powerless? How can taxpayers be sufficiently surveilled to gather the right information without

¹⁹³ Solove, *supra* note 191, at 1121.

¹⁹⁴ *Id.* (quoting Jeffrey Rosen).

¹⁹⁵ *Id.*

¹⁹⁶ Cohen, *supra* note 139, at 1906.

¹⁹⁷ Julie E. Cohen, *Examined Lives: Informational Privacy and the Subject as Object*, 52 STAN. L. REV. 1373, 1373 (2000).

¹⁹⁸ Solove, *supra* note 17, at 1398.

¹⁹⁹ See Daniel J. Solove, *I've Got Nothing to Hide' and Other Misunderstandings of Privacy*, 44 SAN DIEGO L. REV. 745, 762-64 (2007).

²⁰⁰ Cohen, *supra* note 139, at 1905-1907.

²⁰¹ See Daniel J. Solove, *A Taxonomy of Privacy*, 154 PENN L. REV. 477, 488 (2006).

²⁰² Cohen, *supra* note 139, at 1905-6.

sacrificing innovation, citizenship, and culture? These are not so much questions for legal experts as for psychologists, anthropologists, and philosophers.

One of the difficulties of addressing these questions is that the cultural norms as to privacy zones are being transformed by the information technology revolution. It may be that what would be necessary to comfort taxpayers in 2015 is radically different from what will be necessary in 2040. With that in mind, perhaps research will reveal that implementing the system through steps appropriate for the relevant time is the best way forward, presuming that what is appropriate will change with time. Perhaps, as suggested above, the first steps might be taken with respect to the information already reported by third parties, as taxpayers are already conditioned to have little control over this information. Perhaps the next step might be a voluntary program providing a reduced compliance burden in exchange for a greater degree of surveillance. By making the sacrifice of privacy a matter of taxpayer choice, a taxpayer's interest in controlling personal information could be respected. Then, maybe, the next step would be to allow taxpayers to choose between two tax systems, one in which less information is collected but certain benefits are not available, and one in which more information is collected and more benefits are available. For example, in the simplified system, there might be fewer potential benefits for higher education expenses but no need to monitor, for example, the taxpayer's degree progress.²⁰³ Or perhaps the taxpayer should be empowered to opt out of surveillance at certain times or in certain situations, with the provision that there would be no tax benefits available for expenses. For example, a taxpayer might be able to opt out of surveillance of travel with the consequence that none of the travel expenses would be deductible, even if they otherwise would have been. By putting the taxpayer in the control of the surveillance, the taxpayer would control his or her personal information and be able to define his or her privacy zones. The design problem would be to balance these options for the taxpayer with the tax system's interest in collecting all of the relevant information.

At some point, empirical research into exactly what concerns taxpayers and how those concerns might be addressed would be needed. For example, if research determines that taxpayers are most concerned about their personal information being misconstrued, then procedures to ensure accurate analysis might address the concern. If research reveals a great

²⁰³ See, e.g., I.R.C. § 25A(f)(1)(B) (West 2014) (precluding Hope and Lifetime Learning Credits to cover the expenses related to courses involving sports, games, or hobbies unless the course is part of the student's degree program).

concern that the information not be misused, leaked, or hacked, then measures to reduce the chances of misuse or inappropriate dissemination would be the appropriate solution. Research might determine that there is concern that information would be used by agencies other than the IRS, in which case the legal restrictions on the secondary use of information by other agencies may need to be strengthened.²⁰⁴ Such use is already limited, but so is the scope of the information to which the IRS has access. It may be that social research reveals that what matters to taxpayers is not so much the control of *all* personal information, but rather the control of certain types of information. Presumably, taxpayers care less about controlling the information about their paychecks, since their employers already know the amount, than they do in controlling information about their health, even though their doctors are also privy to that knowledge. Protecting taxpayers' privacy means designing a system that values whatever it is that taxpayers value when assessing the flow of their personal information. It would mean designing a system in which taxpayers feel neither dehumanized nor powerless.

It would be important to surveil taxpayers without making them less expressive and innovative. The risk of surveillance is that it reduces creativity, expression, and innovation.²⁰⁵ Over the next twenty-five years, these negative consequences may diminish as cultural norms develop to reflect the new information technology. Of course, since surveillance for any number of purposes will increase, concern for creativity, expression, and innovation is not tax-specific. Yet, to the extent that the tax system would be focused on surveilling economically significant activities, policy makers should think about how to limit economic chilling effects. If a business owner is unduly sensitive to the tax surveillance system, such that she spends less on a business development dinner than she otherwise would, then the restaurant and waitstaff would earn less than they would earn in a world without tax surveillance. More pervasively and more perniciously, if business owners take fewer risks, incline their business decisions towards safety, and temper their entrepreneurial aspirations, the economy as a whole might suffer. Surveilling economic activity could have the consequence of chilling innovative economic activity.²⁰⁶

²⁰⁴ See Solove, *supra* note 201, at 521-22.

²⁰⁵ See, e.g., Cohen, *supra* note 139, at 271; Gray & Citron, *Total Surveillance*, *supra* note 4, at 271; Richards, *supra* note 4, at 1948-50; Solove, *supra* note 191, at 1145-46.

²⁰⁶ Interestingly, but not too surprisingly, when some individual income tax return information was made public for a short period early in the

How would the Tax Surveillance System affect the taxpayer's sense of citizenship? The pervasiveness of the surveillance system could potentially make Americans more aware of federal tax needs, laws, and politics. Indeed, the system could be structured so that taxpayers are able to provide ongoing feedback—communicating to the IRS as taxpayers and to their elected representatives as voters. Perhaps such a system would facilitate the broadening and deepening of civic involvement of taxpayers, and improve democratic participation. Or, it might have the opposite effect. The movement towards the IRS pre-preparing income tax returns has been criticized on grounds relevant to tax surveillance: by making tax compliance less burdensome, taxpayers may lose an important connection to the tax system. For some commentators, the concern is that taxpayers would be less politically inclined to resist tax increases.²⁰⁷ For other commentators, the concern is a more general one about citizens and their awareness of the laws and fulfillment of their duties.²⁰⁸ Becoming an object of ongoing government surveillance no doubt affects how a citizen relates to his or her democratic government, and how that relationship is likely to be affected should be a seriously considered.

The effect of the Tax Surveillance System on a taxpayer's sense of citizenship would be complicated because the surveillance system would not present itself as a "government" system. In fact, there is no system of "government" surveillance. Surveillance is a "linked, shared, and integrated" project of both government agencies and private companies.²⁰⁹ A Tax Surveillance System would not be a system independent of all others. It would be the integration of tax administration systems into the existing, integrated surveillance infrastructure. Currently, even if a citizen's online life mediated through companies such as Google, Facebook, Wikipedia, Amazon, and Youtube is monitored by government agencies, for most citizens, awareness of the monitoring is at a low level or, at least, a low concern. However, if the monitoring

twentieth century, one effect was increased investment in the tax-exempt securities market. The publicity thus decreased the revenue collectible from the income tax. This impact on economic behavior was one of the reasons the Treasury Department opposed publicizing individual income tax information. *Cost of Publicity Scored in Treasury*, N.Y. TIMES, Sept. 3, 1925, at 1.

²⁰⁷ President's Advisory Panel on Federal Tax Reform, Transcript of Ninth Meeting, Implementing a Return-Free Tax Filing Scheme (May 17, 2005), <http://govinfo.library.unt.edu/taxreformpanel/meetings/meeting-05172005.html> (testimony of Grover Norquist).

²⁰⁸ Lawrence Zelenak, *Justice Holmes, Ralph Kramden, and the Civic Virtues of a Tax Return Filing Requirement*, 61 TAX L. REV. 53, 56-65 (2007).

²⁰⁹ Gray & Citron, *Total Surveillance*, *supra* note 4, at 262.

were used to determine tax liabilities, the awareness and concern would be quite different. Receiving a tax return each year reflecting surveilled activities would no doubt increase a taxpayer's self-awareness and would probably affect his or her behavior. Google, Facebook, Wikipedia, Amazon, Youtube and innumerable other companies would mediate the taxpayer's relationship to government. Integrating tax administration into the joint surveillance system would mean integrating one's sense of being a citizen and a consumer, and the likely consequences of fusing these and related roles should be a topic of considerable discussion.

The cooperation between government and private companies in surveilling citizens also raises issues of personal autonomy. Private sector designs increasingly focus on the virtual space in which consumers interact with the company's data collection system in order to gather more information about the consumer than the consumer is aware he or she is providing. They do this in order to exploit the consumer's personal vulnerabilities for company profit.²¹⁰ Even if the information gathered by such methods were within the legal authority of the IRS, such collection methods raise tremendously important issues about citizenship and governance in a free society. It may be quite effective to exploit a taxpayer's vulnerabilities in order to extract the most useful tax-relevant information. And it may even be legal. But there should be considerable debate about the appropriateness in a free society of the government exploiting taxpayers' vulnerabilities to gather tax-relevant information well beyond what the individual likely believes he or she is disclosing.

Yet, what may look like exploiting a taxpayer's vulnerabilities from one perspective may look like merely personalizing a system in a helpful way from another perspective. It may be that the system could be designed in a personalized way to increase a taxpayer's own rationality with respect to tax savings. Perhaps one taxpayer would be best motivated by retirement account contributions, with a spreadsheet of information; another by feedback delivered through a digitized human face;²¹¹ and another by a few lines of a favorite song while filling out a form. The techniques that may discern a taxpayer's vulnerabilities for manipulation might be used to steer the taxpayer towards a lower tax liability. But it is not merely whether the technology would be

²¹⁰ Ryan Calo, *Digital Market Manipulation*, 82 GEO. WASH. L. REV. 995, 995, 1003-05, 1013-15, and 1033.

²¹¹ See generally Ryan Calo, *People Can Be So Fake: A New Dimension to Privacy and Technology Scholarship*, 114 PENN ST. L. REV. 809 (2010) (considering how technologies that imitate human features implicate privacy values).

used to increase or decrease a taxpayer's liability that should be of concern, but also whether the taxpayer would appreciate the way in which he or she was being monitored and manipulated by a government agency.

The concern over how surveillance would affect individual taxpayers should also consider the technological intrusiveness of the system into the taxpayer's life. Technological intrusiveness saps a person's time, attention, and energy by interrupting his or her activities and sense of solitude.²¹² There are great variations among individuals with respect to sensitivities to technological intrusiveness. Relative to a college student, a retired executive might have a greater potential for ever-increasing tax rationality. Yet, the college student might have a higher threshold for technological intrusiveness. An Amish business owner²¹³ might have considerable interest in seeking out tax savings, but, given the sect's resistance to technologies widely used by other Americans, he or she²¹⁴ presumably would resist technological intrusions. Not only are there individual variations in sensitivities *across* individuals, but the *same* individual's sensitivities may vary over short periods. For example, a Sabbath observer would resist any involvement or intrusiveness once a week, no matter his or her preferences on the other six days. The Tax Surveillance System should be designed to respect the autonomy of individuals as members of a free and diverse society. Yet it would also need to be effective. The Sabbath observing taxpayer should be given a day of rest from technological intrusiveness. But the design to accommodate this weekly rest should not provide a weekly opening for tax evasion.

B. *Legal Authority and Limits*

A Tax Surveillance System legal research agenda should address how best to reform the substantive tax law to fit privacy concerns and technological capabilities and should seek to determine the limits of the IRS's information-gathering authority. The latter raises many of the same issues that any widespread government surveillance operation would, but should be framed within the broad authority of the IRS to require and inspect records maintained by the taxpayer and to compel third parties to provide information to the IRS.

²¹² See Solove, *supra* note 201, at 553-555.

²¹³ For a discussion of the success of Amish business owners, see generally DONALD B. KRAYBILL & STVEN M. KNOLT, *AMISH ENTERPRISE: FROM PLOWS TO PROFITS* (1995).

²¹⁴ Although the Amish maintain traditional gender roles, Amish women often run businesses. In some instances, their businesses have been so successful that their husbands have dropped their other employment to work in the wives' businesses. *Id.* at 240-44.

One issue to be resolved is whether the current grant of the right to require and inspect records would be sufficient to allow the IRS to *require* participation in a surveillance system that automatically generated records for IRS inspection. Of course, it is Congress rather than the IRS that would devise a Tax Surveillance System, modifying whatever laws would be necessary to authorize its implementation. Nevertheless, such widespread information gathering may already be within the scope of authority granted to the IRS, given that it is so broad.²¹⁵

Another line of research should inquire into how much information the IRS might be able to obtain from third parties such as Facebook. The IRS has the authority to summon information from knowledgeable third parties.²¹⁶ In practice, the information is provided by third parties merely after an informal request by the IRS.²¹⁷ While Facebook has not publicized how many requests for information it has received from the IRS, it has publicized that it produced information in response to over 35,000 requests from U.S. government agencies in the past year.²¹⁸ If a third party refuses to comply with the informal request, the IRS can formally summons the party and seek to compel production of the information in federal court.²¹⁹ Under current law, the burden on the IRS is not high. It need only act in good faith and issue the summons for a legitimate purpose.²²⁰ There is no need for the IRS to meet any standard of probable cause, but rather only to show that “inquiry may be relevant” and that the IRS does not already have the information.²²¹

²¹⁵ See *supra* notes 5-13 and accompanying text; see also generally Part I.A.

²¹⁶ See Part II.A.

²¹⁷ I.R.C. § 7602(a) (West 2014); MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[1].

²¹⁸ *United States Law Enforcement Requests for Data*, FACEBOOK, [https://govt.requests.facebook.com/country/United States/2014-H2](https://govt.requests.facebook.com/country/United%20States/2014-H2) (last visited Apr. 13, 2015).

²¹⁹ I.R.C. § 7602(a) (West 2014); MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[1].

²²⁰ *United States v. Powell*, 379 U.S. 48, 57-58 (1964); MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[2].

²²¹ The court in *Powell* stated:

[T]he Commissioner need not meet any standard of probable cause to obtain enforcement of his summons. . . . He must show that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner’s possession, and that the administrative steps required by the Code have been followed. It is the court’s process which is invoked to enforce the administrative summons and a court may not permit its process to be abused. Such an abuse would take place if the

Would taxpayers have any Fifth Amendment argument against participating in the Tax Surveillance System? The Fifth Amendment provides limited protection in the tax system. It is not a defense for failing to file an income tax return, even when, for example, the taxpayer is engaged in an illegal business. However, the taxpayer may claim the privilege as to “the specific questions for which a valid privilege exists,” so long as the taxpayer completes “the remainder of the form.”²²² Tax-relevant records that have been voluntarily prepared by the taxpayer have not been compelled and thus do not qualify for Fifth Amendment protection.²²³ However, the acts of “gathering, identifying, and authenticating” the tax relevant records may be testimonial and, therefore, privileged.²²⁴ How should this apply when tax records are automatically generated by and reported to the IRS?

The broad scope of the IRS’s authority to gather information and its constitutional limitations have not been considered in light of the technological capacity to gather all that is allowed. The issues raised by “broad, indiscriminate, and continuous” surveillance²²⁵ are far-reaching and deep. In fact, they are not unique to surveillance for tax purposes. Legal scholars have already discussed similar issues in national security and criminal investigations.²²⁶ But the Supreme Court has only begun to consider how the information-technology revolution affects constitutional rights. In light of *United States v. Jones*, a case in which the Court considered law enforcement’s use of a GPS-tracking device on a suspect’s car, there is reason to anticipate that, in future cases, several Justices will focus on the quantities of information gathered.²²⁷ If the Supreme Court becomes interested in this “quantitative privacy,”²²⁸ any widespread government surveillance system would be implicated, including tax surveillance.

summons had been issued for an improper purpose, such as to harass the taxpayer.

379 U.S. at 57-58; *see also* MCMAHON AND ZELENAK, *supra* note 30, ¶ 47.02[2].

²²² WHITE COLLAR CRIME, *supra* note 77, § 19:93; *see also* Garner v. United States, 424 U.S. 648 (1976) (finding incriminating disclosures of gambling made on tax return to be admissible evidence).

²²³ United States v. Doe, 465 U.S. 605, 612 (1984) (holding that because a taxpayer had voluntarily prepared the records, their production was not compulsory under the Fifth Amendment).

See TOWNSEND ET AL., *supra* note 77, at 238.

²²⁵ Citron & Gray, *Total Surveillance*, *supra* note 4, at 269.

²²⁶ *See id.*; *see also, e.g.*, Richards, *supra* note 4, at 1934.

²²⁷ Gray & Citron, *Quantitative Privacy*, *supra* note 4, at 68 (citing *United States v. Jones*, 132 S. Ct. 945, 963-64 (2012)).

²²⁸ *Id.*

Another constitutional issue raised by this type of surveillance concerns the exercise of fundamental rights. We know that surveillance chills behavior. Surveillance for tax purposes could chill constitutionally protected behavior. For example, when a woman exercises her constitutional right to an abortion, the abortion's potential as a deductible medical expense means that various details—such as the gestational age of the fetus—would be tax-relevant information.²²⁹ Knowing the IRS was collecting this information might chill her choice. Currently, the IRS is entitled to such information, but it is unlikely that it would actually be collected or used for two reasons. First, it is very unlikely many women know of the potential tax relevance of the information. If a woman does not know it is subject to IRS review, it cannot chill her choice. Second, none of the information would ever be requested by the IRS unless the deduction were taken (less than seven percent of returns),²³⁰ the return audited (less than one percent),²³¹ and, even then, only if the particular deduction were questioned. However, under a Tax Surveillance System, the monitoring of medical expenses would be routine. Would the potential chilling of fundamental rights mean that the surveillance system would have to be limited in substantial ways?

Of course, the Constitution is not the only body of law guiding development of a Tax Surveillance System. We ought to think about how the system would interact with existing statutes outside of the Internal Revenue Code. For example, especially as to the information flow gathered from or through third parties, the System's design may need to be coordinated with various statutory schemes: the Bank Secrecy Act of 1970,²³² the Privacy Act of 1974,²³³ the Right to Financial Privacy Act of 1978,²³⁴ the Electronic Communications Privacy Act of 1986,²³⁵ the Computer Matching and Privacy Act of

²²⁹ Only the expenses of legal abortions are deductible. Given the variation of state laws, legality of the abortion would have to be determined on a state-by-state basis, which would require consideration of gestational age. Rev. Rul. 73-201, 1973-1 C.B. 140 (describing deductibility of medical expenses of legal abortion); Rev. Rul. 97-9, 1997-1 C.B. 77 (indicating that legality is essential to deductibility).

²³⁰ Less than seven percent of individual income tax returns reflect the deduction for medical or dental expenses. INTERNAL REVENUE SERV., *Individual Income Tax Returns Bulletin 2011*, at 9, 16, <http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax>Returns> (last visited Aug. 11, 2015).

²³¹ See *supra* note 29.

²³² 12 U.S.C. §§ 1951-1959 (2013).

²³³ 5 U.S.C. § 522a (2013).

²³⁴ 12 U.S.C. §§ 3401-3422 (2013).

²³⁵ Pub. L. No. 99-508, 100 Stat. 1848 (codified as amended in scattered sections of 18 U.S.C.).

1988,²³⁶ and the Health Insurance Portability and Accountability Act of 1996.²³⁷

Finally, research ought to be conducted on how other government agencies might seek to use the information collected through the Tax Surveillance System, and how this ought to be regulated. Under current law, government agencies are able to access information held by the IRS in certain situations.²³⁸ Should greatly increasing the information held by the IRS increase or decrease that access? Anticipating that there would be an increased information flow from the IRS to other agencies highlights the risk that the removal of information from the tax context increases the chances that this information will later be misunderstood.²³⁹ Even when the context is superficially relevant to tax administration, such as in economics or accounting, the tax-law meaning of a word like “income” is quite different than its meaning elsewhere.²⁴⁰ Words in the tax code often have technical meanings that are different than the casual interpretations. For instance, one’s “principal residence” may not be one’s home,²⁴¹ and one’s child may not be one’s “dependent.”²⁴² Characterization in tax law can also be at odds with other legal characterizations. For example, a limited liability company duly organized, operated, and recognized for all state law purposes may be non-existent for tax purposes, with its employees, income, and expenses appearing as its sole member’s own.²⁴³ Thus, the agenda should include not only debating the terms on which other agencies should be able to access the tax information, but also discussing how those agencies could accurately translate information from the tax context into their own.

C. *Tax Surveillance and Tax Reform*

A final set of research questions relate to reforming the tax law itself. The tax system we have is not designed for the information collecting and processing technologies now

²³⁶ Pub. L. No. 100-503, 102 Stat. 2507 (codified as amended in scattered sections of 5 U.S.C.).

²³⁷ Pub. L. No. 104-191, 110 Stat. 1936 (codified as amended in scattered sections of 29 U.S.C., 42 U.S.C., 18 U.S.C., and 26 U.S.C.).

²³⁸ See, e.g., I.R.C. § 6013(i) (West 2014) (permitting disclosure to federal officers or employees for administration of federal laws that do not relate to tax administration).

²³⁹ Solove, *supra* note 204, at 520-22.

²⁴⁰ For example, under I.R.C. § 102, “income” does not include gifts, even though it would for economics or accounting purposes.

²⁴¹ See, e.g., I.R.C. § 121 (West 2014) (noting that one’s principal residence may be a property where one has not lived for as long as three years).

²⁴² See Treas. Reg. § 1.152-1(b) (as amended in 1971).

²⁴³ For the disregarding of single-member limited liability companies, see Treas. Reg. § 301.7701-3(f)(2) (as amended in 2006).

developing. Changes in collection-related technology may make a tax system optimal in one year, but not indefinitely.²⁴⁴ A surveillance-facilitated tax system would be a paradigm shift in collection technology, and we should discuss how substantive tax law ought to be changed to accommodate the shift. We should not anticipate having the 2015 tax law administered by 2040 technologies. So, what should the tax law in 2040 be, in light of these technologies?

These new technologies hold potential for solving the compliance burden and gap problems. They also hold potential for undermining privacy and the goods it protects and promotes. But the administration of an income tax system inevitably requires disclosure of information we otherwise keep private. After all, we do not disclose our paycheck amounts to others, at least not widely or frequently. Indeed, discussions of money matters—even between spouses—tend to be taboo.²⁴⁵ Yet, the income tax system depends on access to private information, and not only about one's paycheck or business, but about one's home, family, and health. Unavoidability justifies some privacy burden on taxpayers, but not *any* burden. Under the current system, only a minuscule amount of information to which the IRS is entitled is actually collected. This does not reflect a privacy policy, but rather other factors, especially the very low audit rate. While Congress has made all sorts of information tax relevant, and while the IRS has the legal authority to demand any tax-relevant information, the practical constraints on gathering and processing information have meant that people have had to give relatively little thought to the scope of tax-relevant information. But in a system in which all of the information that is relevant is gathered and processed, there should be considerably more concern to carefully define what is relevant. The upside of the Tax Surveillance System would be reducing the compliance gap and compliance burden by gathering and processing all of the relevant information; the downside would include the harms to taxpayer privacy, which currently is protected only by practical inabilities.

A fundamental project in integrating tax policy and privacy policy should be assessing the current tax law in light of privacy concerns. We need to devise some way to measure the privacy burdens of the current tax law. Perhaps this begins with measuring the information collection that is already accepted without protest. This is primarily the third-party reported information already collected on almost all taxpayers,

²⁴⁴ Joel Slemrod, *Optimal Taxation and Optimal Tax Systems*, 4 J. ECON. PERSPECTIVES 157, 175 (1990).

²⁴⁵ See, e.g., Joan Atwood, *Couples and Money: The Last Taboo*, 40 AM. J. FAMILY THERAPY 1 (2012).

such as paycheck and dividend amounts.²⁴⁶ Reporting this information does not appear to undermine social good, perhaps because it involves dollar amounts paid to third parties or received from third parties without a cultural expectation of secrecy. This information is collected on most taxpayers, and it is collected routinely.

The information routinely and universally collected should be compared to information that is collectible only in an audit. In an audit situation, the IRS has broad legal authority. As noted, the agency is entitled to any information that may be relevant to determining a tax liability.²⁴⁷ And it is during an audit that the most sensitive information is at risk. For example, an audit of dependent status might require the taxpayer to disclose how many nights of the year the child slept in the taxpayer's house and how many elsewhere,²⁴⁸ the citizenship of the child,²⁴⁹ and whether or not the child has any disabilities.²⁵⁰ If the audit covers adoption expenses, it might include information about the child's special needs,²⁵¹ surrogate parenting arrangements,²⁵² and the legal relationship of the child to the taxpayer's spouse.²⁵³ Under a Tax Surveillance System, all of this information, though rarely gathered now, would always be gathered on all taxpayers to determine if the taxpayer had qualifying dependents and how related expenses should be characterized.

In thinking about this issue, we must not only examine the privacy burdens if all of the information relevant under current law were collected, but must also determine some way to balance the potential privacy harms against the benefits to the taxpayer and the tax system. While it is invasive to investigate the disabilities, special needs, or surrogate parenting arrangements of a child, the information may be essential to accurately measuring the degree of the child's dependence on the taxpayer. The result of this accuracy includes benefits to the taxpayer, such as a credit against tax liabilities for amounts paid to adopt the child.²⁵⁴ Weight also has to be given to the potential for evasion by the taxpayer, since the purpose of the surveillance system would be to reduce the compliance gap while reducing the opportunities for evasion.

²⁴⁶ *See supra* note 65.

²⁴⁷ *See supra* note 23.

²⁴⁸ I.R.C. § 152(c)(1)(B) (West 2014).

²⁴⁹ *Id.* § 152(b)(3).

²⁵⁰ *Id.* § 152(c)(3)(B).

²⁵¹ *Id.* § 23(d)(3).

²⁵² *Id.* § 23(d)(1)(B).

²⁵³ *Id.* § 23(d)(1)(C).

²⁵⁴ *Id.* § 23.

In this balancing, some current provisions likely would be difficult to justify, like the medical expense deduction. First, the deduction is not necessary for the accurate measurement of a taxpayer's economic income.²⁵⁵ Second, collection of medical information tends to involve information that taxpayers would not routinely share outside of particular social circles. Third, not all expenses are deductible. For example, breast augmentation may or may not be deductible. If its purpose is merely to improve appearance, it is not deductible.²⁵⁶ However, if it is to ameliorate a deformity related to disease, then it is deductible.²⁵⁷ The invasiveness of medical care surveillance—such as determining the circumstances of breast augmentations—would rarely be outweighed by the tax benefits to the patient given how few patients would have tax benefits from the medical care payments. No medical expense is deductible by those taxpayers claiming the standard deduction, which is the majority of taxpayers.²⁵⁸ Even among the minority who itemize, the deduction is only available when the total expenses exceed ten percent of the taxpayer's adjusted gross income.²⁵⁹ The deduction is claimed on less than seven percent of returns.²⁶⁰ A tax system that routinely collected all medical information on all taxpayers, but that provided medical-related tax benefits in such limited situations, would be hard to justify.

The exclusion of gain on the sale of the taxpayer's principal residence is a more generous tax benefit.²⁶¹ Like the medical expense deduction, this tax benefit is a deviation from the accurate measurement of income.²⁶² While the exclusion provides a significant tax benefit,²⁶³ determining whether or

²⁵⁵ This deduction is listed on the tax-expenditure budget, a list of tax provisions that deviate from a "normal" measurement of income in order to provide a special provision. In the Joint Committee on Taxation tax-expenditure budget, it is estimated that the medical expense deduction (including long term care deductions) amounted to about \$10 billion in 2014. STAFF OF J. COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018, at 1-2, 31 (2014), available at <https://www.jct.gov/publications.html?func=startdown&id=4663>.

²⁵⁶ I.R.C. § 213(d)(9)(B) (West 2014).

²⁵⁷ *Id.* § 213(d)(9)(A).

²⁵⁸ *See supra* note 46.

²⁵⁹ I.R.C. § 213(a)-(f) (West 2014).

²⁶⁰ *See supra* note 230.

²⁶¹ The gain is potentially excludible under I.R.C. § 121. It is estimated that exclusions under this section amount to about \$30 billion each year, which is about three times the medical expense deduction total. *See supra* note 255, at 26.

²⁶² This deduction is listed on the tax-expenditure budget. STAFF OF J. COMM. ON TAXATION, *supra* note 255, at 5.

²⁶³ I.R.C. § 121(b)(2) (West 2014).

not the sale qualifies could become quite invasive upon audit. For example, relevant information may include information related to multiple birth pregnancies,²⁶⁴ illnesses,²⁶⁵ loss of job or other change in job status²⁶⁶ of the taxpayer or someone living with the taxpayer,²⁶⁷ as well as where the taxpayer's family members live,²⁶⁸ the taxpayer's banks,²⁶⁹ and the identity and location of "religious organizations and recreational club with which the taxpayer is affiliated."²⁷⁰ Routinely collecting this information would involve monitoring the health, employment profile, religious, and recreational habits of taxpayers. Would taxpayers prefer a system with that degree of monitoring, or would they prefer different tax consequences of the sale of a principal residence? Presuming that all relevant information is always collected invariably shifts our perspective. Given the low audit rate, the chances that a taxpayer would have to provide information on his or her banking, religious, and recreational habits is miniscule, even if the taxpayer claims the benefit of the exclusion of gain on the sale of the home. In practice, almost none of this information is ever disclosed to the IRS. The taxpayer does not even have to disclose to the IRS that he or she is claiming the exclusion.²⁷¹ However, if, under the Tax Surveillance System all of the information relevant under current law were actually collected, the balance of harms and benefits would shift, likely indicating that a number of provisions' privacy burdens would not be offset by tax benefits.

Researchers might contemplate ways to retain beneficial tax provisions while reducing their potential privacy burdens. It could be that a systematic review of the case law reveals that judges actually decide issues with reference to far fewer facts than the current Treasury Regulations cover. For example, it may be the case that, in disputes over whether a residence was a taxpayer's principal residence, judges do not consider the proximity of the residence to a religious institution. Similarly, it may be that, even though one judge considers reading habits relevant in determining whether or not a taxpayer had a profit motive or a hobby motive while pursuing a particular activity,²⁷² the best indication of a profit motive is actually the relative ratios of the activity's expenses to the income derived

²⁶⁴ Treas. Reg. § 1.121-3(e)(2)(iii)(E) (as amended in 2004).

²⁶⁵ *Id.* § 1.121-3(d)(1).

²⁶⁶ *Id.* § 1.121-3(e)(2)(iii)(C).

²⁶⁷ *Id.* § 1.121-3(f).

²⁶⁸ *Id.* § 1.121-1(b)(2)(ii).

²⁶⁹ *Id.* § 1.121-1(b)(2)(v).

²⁷⁰ *Id.* § 1.121-1(b)(2)(vi).

²⁷¹ 1040 INSTRUCTIONS 2014, *supra* note 71, at 18.

²⁷² *See supra* note 8.

from the activity.²⁷³ It may be that the information technology revolution itself could be leveraged in this research. Big Data analyses may reveal patterns of relevance we would never discern on our own.

In addition to privacy concerns, considerations of what new technology itself does best would be relevant to guiding the tax system into the technology revolution. It may be that incorporating artificial intelligence into tax administration means that tax law should be reformed to include more rules and fewer standards. Artificial intelligence is better suited for rule-making decisions. In some circumstances, it may be that moving towards rules and away from standards in order to allow greater room for computerizing legal processing is a sacrifice of fairness. In her review of legal automation projects, Danielle Citron concluded that “the emergence of automation threatens to” give rules “a huge, and often decisive, advantage on the basis of cost and convenience rather than the desirability of the substantive results they produce.”²⁷⁴ However, it may be that tax law in particular is better suited for a move towards more rules than some other bodies of law.

While a system of artificial intelligence may accommodate a great deal of complexity, the complexity ultimately should not exceed what a taxpayer can understand and apply without undue difficulty. This issue is best considered in light of the taxpayer’s adversarial rights in the tax system. In the current tax system, the taxpayer is obligated to record relevant facts, interpret the relevant law, and apply it to the facts at hand in preparing the return. The taxpayer does not defend what she has done unless there is an audit and, ultimately, the defense is to a judge, not an IRS agent. For example, a taxpayer who takes a trip somewhat for business reasons and somewhat for personal reasons is obligated to rightly record the expenses of the trip but also to determine if the mixed-motive trip is primarily for business reasons or personal reasons.²⁷⁵ So long as the taxpayer believes she has a pretty good argument (one with “substantial authority”)²⁷⁶ that the mixed-motive trip was primarily for business reasons, she is entitled to deduct the expenses accordingly. Not only is she entitled to give herself the benefit of the doubt, but she is entitled to do so even if she

²⁷³ The taxpayer’s history of income or losses and occasional profits are factors to be considered in determining whether or not there was a requisite profit motive, but alongside, for example, the taxpayers’ degree of personal pleasure in pursuing the activity. *See* Treas. Reg. § 1.183-2(b) (2013).

²⁷⁴ Citron, *supra* note 167, at 1303.

²⁷⁵ Treas. Reg. § 1.162-2 (1960) (covering travel for business, mixed business, and personal reasons).

²⁷⁶ *See supra* note 33.

thinks a court likely would disagree.²⁷⁷ But in a surveillance-based tax system, the system would collect the relevant data—perhaps how many minutes were spent in the client’s office and how many minutes were spent in a friend’s house—and tentatively conclude whether the trip was more business related or personal. The return would be drafted on that basis, though the taxpayer would have right to dispute it and appeal to the judiciary. Of course, for the taxpayer to dispute it, she would have to be informed as to how the conclusion was formed. The system would have to reveal how the decision was made and how the legal authorities were interpreted and applied in a way that the taxpayer could understand and respond. This is a matter of what has been called “technological due process,” meaning that these sorts of automated decisions cannot be made within black boxes.²⁷⁸

Ultimately, transparency must be found not only in the conclusions on individual taxpayer returns, but also in the design of the automated decision-making process. It would require a process with public notice, comments, and hearings.²⁷⁹ Commenting on proposed Treasury Regulations requires tax expertise. But to comment on the process of coding the law and regulations would require not only tax expertise, but also some understanding of the computer coding process. Computer codes have a more limited vocabulary than the law.²⁸⁰ The combination of this limited expertise and limited vocabulary has led to substantial distortions of the law when decision-making has been automated in other areas.²⁸¹ This makes the transparency of coding the project more important, in that independent tax experts need to be watching for such distortions. While tax experts may appreciate the complexities of the law and different understandings of how to resolve substantive legal uncertainties, they mostly cannot appreciate the complexities of the computer code and different ways of reflecting uncertainties in it. Part of the research agenda thus must be reconciling the complexities of the tax law and computer code, and doing so in a way that is transparent and subject to public review and comment.

In light of these issues, it seems that the tax law of 2040 should be fundamentally different than that of 2015 if revolutionary information technologies are to be integrated into its administration. What we must contemplate are not so much

²⁷⁷ *Id.*

²⁷⁸ Citron, *supra* note 167, at 1253, 1276-77, 1308.

²⁷⁹ *Id.* at 1289.

²⁸⁰ *Id.* at 1290.

²⁸¹ *Id.* at 1256-58 (noting that mistakes of this type (and others) led the Colorado public benefits system to hundreds of thousands of incorrect benefits determinations).

the details of the current system and the challenges of updating and fitting it to cutting-edge technology, but the prospects for a tremendously reformed tax system. It probably would require tremendous reform to build a tax system that could be integrated with technology without unduly undermining taxpayer privacy and autonomy. The system best integrated with technology and most protective of privacy and autonomy might not be based on income. In the past, in isolated instances, tax base reform advocates have included tangential privacy considerations.²⁸² However, compared to the current world where almost no individual taxpayers are audited, a future, technology-driven world should push privacy and autonomy concerns to the fore.

While the IRS has always been an “information intensive enterprise,”²⁸³ it is the agency’s practical inabilities to collect and analyze all of the information relevant to a taxpayer’s liability that has protected taxpayer privacy. But, in a not too distant future, “every animate and inanimate object on earth”²⁸⁴ may generate data that the IRS is able to gather. Now seems like a good time to start the discussion.

²⁸² See, e.g., STEPHEN MOORE, THE ECONOMIC & CIVIL LIBERTIES CASE FOR A NATIONAL SALES TAX, in FRONTIERS OF TAX REFORM (1996), available at <http://www.cato.org/publications/speeches/economic-civil-liberties-case-national-sales-tax> (explaining that, of the current proposed reforms, the “sales tax is the only plan that solves the invasive nature of the current system”); Cynthia Blum, *The Flat Tax: A Panacea for Privacy Concerns?*, 54 AM. U. L. REV. 1241 (2005); DAN MITCHELL, INST. FOR POLICY INNOVATION, TAX REFORM: THE KEY TO PRESERVING PRIVACY AND COMPETITION IN A GLOBAL ECONOMY at i (2002) (“Americans suffer from an assault on their privacy because of the way our tax code taxes income”).

²⁸³ *Schulman*, *supra* note 1.

²⁸⁴ SMOLAN & ERWITT, *supra* note 2.